AUSTRALIAN COMPETITION TRIBUNAL

Applications by CitiPower Pty Ltd and Powercor Australia Ltd [2017] ACompT 4

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| Review from: | Australian Energy Regulator *Final Decision:* *CitiPower distribution determination 2016 to 2020*  Australian Energy Regulator *Final Decision:* *Powercor distribution determination 2016 to 2020* |
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| File numbers: | ACT 4 of 2016  ACT 5 of 2016 |
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| Tribunal: | **ROBERTSON J (DEPUTY PRESIDENT)**  **MR RF SHOGREN (MEMBER)**  **DR DR ABRAHAM (MEMBER)** |
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| Date of Determination: | 17 October 2017 |
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| Catchwords: | **ENERGY AND RESOURCES** – applications under s 71B of the *National Electricity Law* for review of distribution determinations by the Australian Energy Regulator (**AER**) – whether reviewable error on the part of the AER – topics for review – adjusting base operating expenditure using an average of capitalised overheads for the three year period from 2012-2014 (corporate overheads expensing issue) –determining a labour price growth rate for 2016 based on the average of two forecasts of the rate of change in the wage price index for the Victorian electricity, gas, water and waste services (utilities) industry (labour price growth issue) |
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| Legislation: | *National Electricity Law*  *National Electricity (Victoria) Act 2005* (Vic)  *National Electricity Rules* |
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| Cases cited: | *Application by SA Power Networks* [2016] ACompT 11  *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79; 345 ALR 1  *Toyota Motor Corporation Australia Ltd v Marmara* [2014] FCAFC 84; 222 FCR 152 |
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IN THE AUSTRALIAN COMPETITION TRIBUNAL

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|  | | ACT 4 of 2016 |
| RE: | IN THE MATTER OF APPLICATION UNDER SECTION 71B OF THE NATIONAL ELECTRICITY LAW FOR A REVIEW OF A DISTRIBUTION DETERMINATION MADE BY THE AUSTRALIAN ENERGY REGULATOR IN RELATION TO CITIPOWER PTY LTD PURSUANT TO CLAUSES 6.11.1 AND 11.60 OF THE NATIONAL ELECTRICITY RULES | |
| By: | CITIPOWER PTY LTD (ACN 064 651 056)  Applicant | |

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| tribunal: | ROBERTSON J (DEPUTY PRESIDENT)  MR RF SHOGREN (MEMBER)  DR DR ABRAHAM (MEMBER) |
| date of determination: | 17 OCTOBER 2017 |

THE TRIBUNAL DETERMINES THAT:

1. The reviewable regulatory decision, being the *Final Decision:* *CitiPower distribution determination 2016 to 2020*, is affirmed.

THE TRIBUNAL NOTES**:** the AER’s error in calculation identified at [376] of its reasons in *Application by ActewAGL Distribution* [2017] ACompT 2 and, in accordance with [377] of those reasons, leaves it to the AER to determine the appropriate response to its error.

IN THE AUSTRALIAN COMPETITION TRIBUNAL

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|  | | ACT 5 of 2016 |
| RE: | IN THE MATTER OF APPLICATION UNDER SECTION 71B OF THE NATIONAL ELECTRICITY LAW FOR A REVIEW OF A DISTRIBUTION DETERMINATION MADE BY THE AUSTRALIAN ENERGY REGULATOR IN RELATION TO POWERCOR AUSTRALIA LTD PURSUANT TO CLAUSES 6.11.1 AND 11.60 OF THE NATIONAL ELECTRICITY RULES | |
| By: | POWERCOR AUSTRALIA LTD (ACN 064 651 109)  Applicant | |

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| TRIBUNAL: | ROBERTSON J (DEPUTY PRESIDENT)  MR RF SHOGREN (MEMBER)  DR DR ABRAHAM (MEMBER) |
| DATE OF  DETERMINATION: | 17 October 2017 |

THE TRIBUNAL DETERMINES THAT:

1. The reviewable regulatory decision, being the *Final Decision: Powercor distribution determination 2016 to 2020*, is affirmed.

THE TRIBUNAL NOTES: the AER’s error in calculation identified at [376] of its reasons in *Application by ActewAGL Distribution* [2017] ACompT 2 and, in accordance with [377] of those reasons, leaves it to the AER to determine the appropriate response to its error.

REASONS FOR DETERMINATION

THE TRIBUNAL:

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| INTRODUCTION | [1] |
| THE STATUTORY FRAMEWORK | [6] |
| CORPORATE OVERHEADS EXPENSING | [10] |
| What the AER decided | [10] |
| The Minister’s submissions to the Tribunal | [15] |
| The AER’s submissions | [25] |
| CitiPower and Powercor’s submissions | [38] |
| The Tribunal’s analysis | [46] |
| LABOUR PRICE GROWTH ISSUE | [57] |
| Introduction | [57] |
| What the AER decided | [64] |
| CUAC’s submissions to the Tribunal | [73] |
| The Applicants’ submissions | [74] |
| The AER’s submissions | [94] |
| Further submissions | [115] |
| The Tribunal’s analysis | [119] |
| CONCLUSION AND DETERMINATION | [142] |

# INTRODUCTION

1. These reasons concern two issues which involve only two distribution network service providers (**DNSPs**), CitiPower Pty Ltd (**CitiPower**) and Powercor Australia Ltd (**Powercor**).
2. These reasons are to be read with the reasons in *Application by ActewAGL Distribution* [2017] ACompT 2. Those reasons provide the relevant background.
3. As there stated, the Minister for Energy, Environment and Climate Change for the State of Victoria (the **Minister**) intervened in the present reviews pursuant to s 71J(b) of the *National Electricity Law* (***NEL***).
4. The Minister raised corporate overheads expensing in ACT 4 and 5 of 2016 (CitiPower and Powercor) only. That issue is whether there was reviewable error in the Australian Energy Regulator (**AER**) adjusting base operating expenditure (**opex**) using an average of capitalised overheads for the three-year period from 2012-2014. It was agreed that that issue should be determined on the papers.
5. The other issue involving CitiPower and Powercor only is referred to as labour price growth rates. CitiPower and Powercor submitted that the AER rejected their proposed labour price growth rate for 2016 based on their existing enterprise agreement outcomes and determined a labour price growth rate for 2016 based on the average of two forecasts of the rate of change in the wage price index for the Victorian electricity, gas, water and waste services (utilities) industry. On 26 August 2016, the Tribunal granted CitiPower and Powercor leave to apply for review in respect of their grounds for review in respect of that matter.

# THE STATUTORY FRAMEWORK

1. It is worth repeating the basis of the Tribunal’s powers of review.
2. Section 71C of the *NEL* provided:

**71C Grounds for review**

(1) An application under section 71B(1) may be made only on 1 or more of the following grounds:

(a) the AER made an error of fact in its findings of facts, and that error of fact was material to the making of the decision;

(b) the AER made more than 1 error of fact in its findings of facts, and that those errors of fact, in combination, were material to the making of the decision;

(c) the exercise of the AER's discretion was incorrect, having regard to all the circumstances;

(d) the AER's decision was unreasonable, having regard to all the circumstances.

(1a) An application under section 71B(1) must also specify the manner in which a determination made by the Tribunal varying the reviewable regulatory decision, or setting aside the reviewable regulatory decision and a fresh decision being made by the AER following remission of the matter to the AER by the Tribunal, on the basis of 1 or more grounds raised in the application, either separately or collectively, would, or would be likely to, result in a materially preferable NEO decision.

(2) It is for the applicant to establish a ground listed in subsection (1) and the matter referred to in subsection (1a).

1. The “national electricity objective” (**NEO**) was set out in s 7 and stated as follows:

**7 National electricity objective**

The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to--

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system.

1. The expression “materially preferable NEO decision” was defined in s 71A with reference to s 71P(2a)(c) as follows:

**71P Tribunal must make determination**

1. If, following an application, the Tribunal grants leave in accordance with section 71B(1), the Tribunal must make a determination in respect of the application.

See section 71Q for the time limit within which the Tribunal must make its determination.

(2) Subject to subsection (2a), a determination under this section may--

(a) affirm the reviewable regulatory decision; or

(b) vary the reviewable regulatory decision; or

(c) set aside the reviewable regulatory decision and remit the matter back to the AER to make the decision again in accordance with any direction or recommendation of the Tribunal.

(2a) Despite subsection (2), the Tribunal may only make a determination--

(a) to vary the reviewable regulatory decision under subsection (2)(b); or

(b) to set aside the reviewable regulatory decision and remit the matter back to the AER under subsection (2)(c),

if--

(c) the Tribunal is satisfied that to do so will, or is likely to, result in a decision that is materially preferable to the reviewable regulatory decision in making a contribution to the achievement of the national electricity objective (a **“materially preferable NEO decision”**) (and if the Tribunal is not so satisfied the Tribunal must affirm the decision); and

(d) in the case of a determination to vary the reviewable regulatory decision--the Tribunal is satisfied 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 reviewable regulatory decision and remit the matter to the AER to make the decision again.

(2b) In connection with the operation of subsection (2a) (and without limiting any other matter that may be relevant under this Law)--

(a) the Tribunal must consider how the constituent components of the reviewable regulatory decision interrelate with each other and with the matters raised as a ground for review; and

(b) without limiting paragraph (a), the Tribunal must take into account the revenue and pricing principles (in the same manner in which the AER is to take into account these principles under section 16); and

(c) the Tribunal must, in assessing the extent of contribution to the achievement of the national electricity objective, consider the reviewable regulatory decision as a whole; and

(d) the following matters must not, in themselves, determine the question about whether a materially preferable NEO decision exists:

(i) the establishment of a ground for review under section 71C(1);

(ii) consequences for, or impacts on, the average annual regulated revenue of a regulated network service provider;

(iii) that the amount that is specified in or derived from the reviewable regulatory decision exceeds the amount specified in section 71F(2).

(2c) If the Tribunal makes a determination under subsection (2)(b) or (c), the Tribunal must specify in its determination--

(a) the manner in which it has taken into account the interrelationship between the constituent components of the reviewable regulatory decision and how they relate to the matters raised as a ground for review as contemplated by subsection (2b)(a); and

(b) in the case of a determination to vary the reviewable regulatory decision--the reasons why it is proceeding to make the variation in view of the requirements of subsection (2a)(d).

(3) For the purposes of making a determination of the kind in subsection (2)(a) or (b), the Tribunal may perform all the functions and exercise all the powers of the AER under this Law or the Rules.

(4) (Repealed)

(5) A determination by the Tribunal affirming, varying or setting aside the reviewable regulatory decision is, for the purposes of this Law (other than this Part), to be taken to be a decision of the AER.

# CORPORATE OVERHEADS EXPENSING

#### What the AER decided

1. In its Distribution Determination for CitiPower, the AER included an adjustment for corporate overheads in its opex forecast. This reflected a change in CitiPower’s capitalisation policy for those costs. Whereas previously CitiPower partially capitalised those costs, from 2016 it would fully expense them, the AER said. This was the primary reason for the forecast increase in opex between 2015 and 2016.
2. In Attachment 7, at 7-45, the AER said it had maintained an adjustment to base opex for corporate overheads. In its *preliminary* decision, the AER had accepted an adjustment to base opex for this change in CitiPower’s capitalisation policy in relation to corporate overheads. Consistent with its approved Cost Allocation Method (**CAM**), the AER accepted this adjustment. This was the main reason the AER’s estimate of forecast opex increased relative to CitiPower's historical opex. However, the AER used a different amount to the amount CitiPower proposed in the AER’s preliminary decision opex forecast. CitiPower proposed that the adjustment be based on its 2014 capitalised overheads. For a number of reasons the AER considered an average of 2012 to 2014 capitalised overheads was preferable to CitiPower’s approach. In particular, the AER said:

* Expenditure in a single year was often affected by non-recurrent factors. If these costs were higher than average in the most recent audited year, forecast opex would be higher than required to meet the opex objectives. The AER observed that CitiPower’s capitalised corporate overheads in 2014 were materially higher than earlier years and it considered this could have been affected by non-recurrent factors in this year.
* No incentive mechanism applied to CitiPower’s capex in the 2011-15 regulatory control period. Without such a mechanism, its incentive to incur efficient capex declined over the 2011-15 period. This meant, all else being equal, it was incentivised to delay its capital expenditure towards the end of the period. There was a relatively weak incentive applying to capitalised corporate overhead expenditure in 2014.

1. CitiPower accepted the AER’s adjustment for capitalised corporate overheads in its revised proposal. However, the Minister considered it was unclear why the AER had chosen an average of CitiPower’s 2012 to 2014 capitalised corporate overheads. It suggested an average of 2010 to 2014 to be preferable because it would be equivalent to applying an efficiency sharing scheme. It also noted it was consistent with the way the AER applied the service target performance incentive scheme (**STPIS**).
2. The AER said in its Distribution Determination that the methodology used when forecasting was a matter of judgment. If it used an average of historical costs, the longer the period the greater the risk was that it would be taking into account information which was no longer relevant - such as the growth in customer numbers, change in regulatory requirements or efficient wage levels. In this instance, the AER said, it was its judgment that a three-year average was sufficient to ensure that the adjustment for CitiPower’s corporate overheads was not unduly influenced by non-recurrent factors. It did not consider its adjustment needed to replicate the outcomes if an efficiency sharing scheme were in place, or its opex forecasting approach needed to be consistent with how STPIS targets were set.
3. In relation to Powercor, the AER adopted the same approach and reasoning: see Attachment 7, at 7-45 of that Distribution Determination.

#### The Minister’s submissions to the Tribunal

1. CitiPower and Powercor did not challenge that decision.
2. The Minister submitted to the Tribunal that the *National Electricity Rules* (***NER***) required DNSPs to submit a proposed CAM to the AER for approval, which set out the principles and policies by which a DNSP proposed to allocate costs between different categories of services for regulatory purposes: rr 6.15.4 and 11.17.5. The CAM proposed must give effect to and be consistent with the Cost Allocation Guidelines made and published by the AER (rr 6.15.3 and 11.17.4), which in turn must give effect to and be consistent with the Cost Allocation Principles (as set out in r 6.15.2).
3. DNSPs were required to comply with the CAM which applied to them and had been approved by the AER: r 6.15.1. In particular:

* a DNSP’s building block proposal must include the total forecast opex and capex for the relevant regulatory control period which the DNSP considers is required to achieve each of the opex and capex objectives (respectively): rr 6.5.6(a) and 6.5.7(a); and
* these forecasts must, among other things, be for expenditure that is properly allocated to standard control services in accordance with the principles and policies set out in the CAM for the DNSP: rr 6.5.6(b) and 6.5.7(b).

1. The Minister submitted to the Tribunal that pursuant to r 6.15.4(f) of the *NER*, both CitiPower and Powercor sought AER approval of a revised cost allocation method which the AER granted on 17 October 2014. Both service providers sought that the amount to be expensed be fixed by reference to the amount for corporate overheads in the year 2014, which was materially higher than in previous years.
2. The use by the AER of an average of capitalised overheads over a three-year period from 2012-2014 resulted in a higher figure than if the full five-year period had been used.
3. In response to the preliminary decisions for CitiPower and Powercor, the Minister’s January 2016 submission to the AER raised that the AER had only averaged capitalised overheads over the 2012-2014 period rather than the entire period of the previous regulatory control period, being from 2010-2014. The Minister argued that the AER should adjust base opex using an average of capitalised overheads for the entire 2010-2014 period, given that no efficiency sharing scheme applied to capital expenditure in that regulatory control period, meaning that the incentives for efficiency gains were greater at the start of a regulatory control period. The Minister also argued this would be equivalent to the way STPIS targets were rolled forward.
4. The Minister’s grounds for review relevant to this issue were as follows:

**Ground 7**: The AER’s decision to adjust base opex using an average of capitalised overheads for the three-year period from 2012–2014, rather than the full five-years of the previous regulatory control period, was unreasonable having regard to all the circumstances and/or the AER’s exercise of discretion in this respect was incorrect having regard to all the circumstances because:

(a) the AER’s decision results in an adjustment to base opex which is higher than would be the case if an adjustment were made based on averaging capitalised overheads for the full five years of the previous regulatory control period;

(b) the AER did not address the Minister’s submission that, in the absence of an efficiency sharing scheme, a DNSP’s incentives for efficiency gains are greater at the start of a regulatory control period;

(c) there may be ‘non-recurrent factors’ equally applicable to all years of a regulatory control period, not just the first two years. Excluding the first two years on that basis is not logical;

(d) asserting it is simply a matter of ‘judgment’ is contrary to section 16(1)(d) [of the *NEL*] whereby the AER is required to make the decision that is the preferable reviewable regulatory decision and specify the reasons as to the basis on which the AER is satisfied that the decision is the preferable reviewable regulatory decision.

1. The Minister contended that the Tribunal making a determination pursuant to s 71P to vary the Final Decision, or set it aside and remit the matter back to the AER, on these grounds, would or be likely to result in a “materially preferable NEO decision” having regard to the long term interests of consumers in that:

(a) the period of averaging, if set at five years, would reduce the amount charged to consumers;

(b) the period of averaging, if set at three years and if the balance first two years was kept by CitiPower and Powercor, results in CitiPower and Powercor receiving monies that should be more properly the consumers’ over the 2016–2010 regulatory control period.

1. The Minister submitted that the AER misstated her position in making the Final Decisions. The Minister submitted she did not suggest that averaging capitalised corporate overheads over the period 2010-2014 would be the equivalent to applying an efficiency sharing scheme. Rather, her point was that, in the absence of an efficiency sharing scheme for capex in the 2010-2014 period, the incentives of the DNSPs to achieve efficiency in capex were greater at the start of a regulatory control period (as was acknowledged by the AER). By averaging capitalised corporate overheads over the three year period 2012-2014, the AER only took into account the years in which the DNSPs had a lesser incentive to achieve efficiency in corporate overhead costs. In doing so, the AER allowed a larger positive adjustment in base opex than would have been generated by averaging corporate overheads over the entire 2010-2014 period, unreasonably skewing the adjustment in favour of CitiPower and Powercor by a material amount.
2. The Minister submitted that if the AER decision were not set aside, CitiPower and Powercor would receive a windfall gain without there being any commensurate benefit for consumers in terms of the NEO. In particular, there would be no commensurate benefit in terms of quality, safety, reliability or security of supply. There would be however a detriment to consumers in terms of the price paid by consumers, ie a price that was higher than it should be. What was really no more than a change in accounting practice should not be allowed to have this effect: and that it had this effect spoke to there being a materially preferable NEO decision arising from setting aside the AER decision.

#### The AER’s submissions

1. The AER submitted that the Minister’s submission that the AER’s use of the 3-year historical average was an incorrect exercise of discretion, and resulted in the AER making an unreasonable decision, in all the circumstances, should be rejected. The AER’s choice to average the historical corporate overheads over the 3-year period was an exercise of regulatory judgment and was correct.
2. In any event, the AER submitted, the difference between applying a 3-year or a 5-year historical averaging period did not materially affect either CitiPower and Powercor’s opex allowances, or their aggregate revenue allowances under their distribution determinations. The AER submitted that a comparison between the adjustment for capitalised corporate overhead expenditure initially proposed by CitiPower/Powercor, as finally determined by the AER, and as contended for by the Minister, were:

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|  | **CitiPower** | **Powercor** |
| Initial proposal | $19.0 m | $34.7 m |
| Final decision | $17.5 m | $31.7 m |
| Minister’s proposed revision | $16.4 m | $30.3 m |

1. In relation to the Minister’s first complaint, ground 7(a), the AER submitted that the fact that the outcome of the forecasting method applied by the AER was different to some alternative outcome did not, of itself, establish that the AER exercised its discretion incorrectly, or that the decision as a whole was unreasonable in all the circumstances.
2. In relation to the Minister’s second complaint, ground 7(b), the AER submitted that the criticism was unfounded. What the AER set out at Attachment 7, 7-46, was simply another way of stating the Minister’s proposition. Plainly the AER was aware of the proposition and took it into account. In addition, the AER expressly noted the Minister’s submissions regarding efficiency sharing schemes and provided two responses. The AER submitted that it did not mischaracterise or misunderstand the Minister’s submission.
3. In relation to the Minister’s third complaint, ground 7(c), the AER submitted this ground was not elaborated upon in the Minister’s submissions and the basis for the assertion of illogicality was unclear. It was plainly the case that, as the AER reasoned, the further back one took an averaging period, the less likely it was that the average will be reflective of CitiPower and Powercor’s current circumstances at the outset of the 2016-2020 period. In light of the identified and unchallenged risks associated with using data that was no longer relevant, it was not illogical for the AER to decide to use a 3-year historical average.
4. In relation to the Minister’s fourth complaint, ground 7(d), the AER submitted first that its obligation to make the preferable reviewable regulatory decision (*NEL*, s 16(1)(d)) was an obligation that related to the distribution determination as a whole. The AER had addressed that requirement, at the level of the distribution determinations as a whole, in the Overview to each of the Final Decisions. It was not the case that each decision made in the course of determining forecast opex was itself required to be the preferable reviewable regulatory decision.
5. Secondly, the AER submitted, once it had decided to apply a historical average, rather than simply accept CitiPower and Powercor’s proposal to adopt their actual corporate overhead expenditure in 2014, that necessarily raised the question of what historical averaging period should be applied instead. The appropriate length of that averaging period was properly understood and described as a matter of judgment, given that there were competing factors at play.
6. In any event, the AER submitted, in considering the Minister’s submission for the use of a 5-year averaging period, in the absence of a capex incentive scheme, it was not the case that a 2010-2014 averaging period would necessarily have reflected stronger overall efficiency incentives than the 2012-2014 averaging period that the AER used. This was because the two additional years that the Minister sought to include encompassed both the final year of the 2006-2010 regulatory control period — when the capex efficiency incentives were weakest — and the first year of the 2011-2015 regulatory control period — when the incentives were strongest. The differing strengths of the efficiency incentives in those two successive years meant there was no obvious reason to prefer the Minister’s proposed 5-year period to the 2012-2014 period used by the AER (which spanned the 3 middle years of the 2011-2015 regulatory control period).
7. Thirdly, the AER did not simply assert this was a matter of judgement without giving reasons, as the Minister’s ground implied. It explained the basis for its judgement. Thus the Minister’s criticism was unfounded.
8. Fourthly in relation to this ground, the AER submitted it was necessary to keep in mind the nature of the constituent decision that the AER was making under the *NER*.
9. The “reasonably reflects” formulation was plainly intended to acknowledge that no forecast could be exact, and that the AER’s determination of a substitute estimate of overall opex would not be incorrect or unreasonable merely because it differed from some other forecast amount.
10. In this case, if the AER had estimated CitiPower and Powercor’s base corporate overhead opex using a 5-year, rather than a 3-year, historical average, it would reduce the overall 2016-2020 forecast opex:

(a) of CitiPower (total opex: $426.6 million) by $5.2 million, or 1.2%; and

(b) of Powercor (total opex: $1,181.1 million) by $6.9 million, or 0.6%.

1. Accordingly, the AER submitted that, even if the Tribunal were of the view that the AER should have used a 5-year historical average, this did not demonstrate that the AER’s assessment of the overall estimate opex requirements for CitiPower and Powercor did not “reasonably reflect” the opex criteria. Moreover, the third opex criterion — a realistic expectation of the demand forecast and cost inputs required to achieve the opex objectives — underscored the need to avoid basing forecast costs on historical expenditures incurred under outdated demand and cost conditions.

#### CitiPower and Powercor’s submissions

1. CitiPower and Powercor supported the AER’s decision. They submitted that, contrary to the Minister’s assertion, the AER’s decision to adjust base opex for corporate overheads using an average of capitalised corporate overheads for the three year period from 2012 to 2014, rather than the five year period from 2010 to 2014, did not involve an incorrect exercise of discretion in all the circumstances and did not render the AER’s Final Decisions unreasonable in all the circumstances.
2. The AER did not err in determining the adjustment to base opex for corporate overheads using an average of each of CitiPower and Powercor’s capitalised corporate overhead expenditure between 2012 and 2014. The AER’s exercise of discretion was not incorrect and did not render its Final Decisions unreasonable for the reasons alleged by the Minister as:

(a) the relevant AER discretion was properly characterised as being a choice of the method, more specifically the historical averaging period, that was best suited for use in forecasting opex on corporate overheads for the 2016 to 2020 regulatory control period that reasonably reflected the opex criteria, that is forecasting efficient and prudent corporate overheads for the period, having regard to a range of competing considerations;

(b) the AER’s decision to strike the balance between those competing considerations in the way that it did, by using the 2012 to 2014 historical averaging period, was correct and reasonable, including because: it was reasonable for the AER to conclude, and there was no error in its conclusion, that three years was a sufficient historical averaging period to ensure the adjustment to base opex for CitiPower and Powercor’s corporate overheads, and thus forecast opex for the 2016 to 2020 regulatory control period was not unduly influenced by non-recurrent factors or the relatively weak efficiency incentives applying to capitalised corporate overheads expenditure in 2014; and the AER was correct to conclude that the longer the historical averaging period adopted, the greater the risk that information lacking in currency and relevancy would be taken into account in forecasting future opex.

1. In any event, CitiPower and Powercor submitted the grounds raised by the Minister were incapable of constituting reviewable error. The fact that the AER’s adjustment to base opex for CitiPower and Powercor was higher than would be the case if the adjustment were based on averaging capitalised overhead expenditure over the period 2010 to 2014 did not in itself suggest any error in the AER’s exercise of discretion, nor that the AER’s Final Decisions were unreasonable. Nor did the AER’s failure to expressly address the Minister’s submission that, in the absence of an incentive scheme, a DNSP’s incentives for efficiency gains were greater at the start of a regulatory control period suggest that the AER’s exercise of discretion was incorrect or render the Final Decisions unreasonable, including because the AER nonetheless had express regard to the reduction in capex efficiency incentives over the 2011-2015 regulatory control period due to the absence of any capex incentive scheme in both its Preliminary Determinations and Final Decisions.
2. CitiPower and Powercor submitted that the Minister’s contention, that excluding the first two years of the Minister’s proposed 2010 to 2014 period on the basis of “non-recurrent factors” was illogical because those factors were equally applicable to all years of the period, was inapposite to the AER’s decision. The AER’s decision was not made on the basis asserted by the Minister. The AER’s determination not to take the average of CitiPower and Powercor’s capitalised corporate overheads over a five year period was not on the basis there may be non-recurrent factors applicable to the first two years of the 5-year period. Rather, the AER determined that a three year average was of sufficient length to ensure that the adjustment for corporate overheads was not unduly influenced by non-recurrent factors and that adopting a longer period would result in greater risk that it would be taking into account information which was no longer relevant for forecasting future opex due to changed circumstances over time, such as growth in customer numbers, changes in regulatory requirements and the like.
3. Contrary to the Minister’s contention, CitiPower and Powercor submitted, the AER’s obligation under s 16(1)(d) of the *NEL* to make the NEO preferable decision and specify reasons for its conclusion that the decision made was the NEO preferable decision did not assist the Minister to establish error or unreasonableness in the AER’s decision to use 2012 to 2014 as the historical averaging period in adjusting base opex for corporate overheads notwithstanding its discretionary nature, including because the obligation to make the NEO preferable decision, and provide reasons, applied in relation to the overall Final Decisions, not individual constituent decisions such as the opex constituent decision under r 6.12.1(4) of the *NER* or decisions antecedent to the making of those constituent decisions such as the decision of present concern and the Minister has not raised any ground of review in relation to the AER’s finding in the Final Decisions to the effect that those determinations were, in each instance, the NEO preferable decisions.
4. CitiPower and Powercor submitted that AER’s decision to strike the balance between the competing considerations in the way that it did, by using the 2012 to 2014 historical averaging period, was reasonably open to it, and could not be said to be incorrect or unreasonable: it was reasonable for the AER to conclude that three years was a sufficient period to address the identified possibility that their 2014 corporate overheads could be affected by non-recurrent expenditure and the relatively weak incentive that it considered applied to the their capitalised corporate overheads in 2014. Following its consideration of the capitalised corporate overheads over the period 2009 to 2014 and of the evidence before it as to the drivers of the increase in those overheads in 2014, the AER did not conclude that the 2014 capitalised corporate overheads were affected by non-recurrent factors but rather that they could have been, such that they did not have “sufficient confidence” that the use of CitiPower and Powercor’s 2014 capitalised corporate overheads for the adjustment to opex would be reflective of their recurrent expenditure on corporate overheads.
5. As the AER explained in its Preliminary Determinations, its concerns about non-recurrent expenditure were confined to the 2014 year because it identified that capitalised corporate overheads increased in 2014 materially compared to earlier years and the evidence before the AER at the time of the Preliminary Determinations as to the drivers of the increase in 2014 disclosed that non-recurrent factors might be a contributor to the increase.
6. CitiPower and Powercor submitted it was reasonable for the AER to conclude, on the basis of the evidence before it, that adopting an average of capitalised corporate overheads over 2012 to 2014 would suffice to address the effects of any non-recurrent factors.

#### The Tribunal’s analysis

1. The Tribunal finds as follows.
2. For the following reasons, the ground of review contended for by the Minister is not made out.
3. The nature of the task in which the AER was engaged was to make a decision in which, having not accepted the total of the forecast operating expenditure for the regulatory control period included in the current building block proposal, the AER, having set out its reasons for that decision, was required to set out an estimate of the total of the DNSPs’ required opex for the regulatory control period that the AER was satisfied reasonably reflected the operating expenditure criteria, taking into account the operating expenditure factors: see r 6.12.1(4)(ii) of the *NER*.
4. Pursuant to r 6.5.6(c) of the *NER*, the AER’s task was to satisfy itself that the total of the forecast operating expenditure for the regulatory control period reasonably reflected each of the following (the operating expenditure criteria):

(1) the efficient costs of achieving the operating expenditure objectives; and

(2) the costs that a prudent operator would require to achieve the operating expenditure objectives: and

(3) a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives.

1. The Tribunal notes that the Minister’s grounds of review did not claim that the AER made an error of fact, or more than one error of fact, in its findings of facts.
2. It does not establish reviewable error to say no more than that the AER’s decision resulted in an adjustment to base opex which was higher than would be the case if an adjustment were made based on averaging capitalised overheads for the full five years of the previous regulatory control period. We do not accept the Minister’s first ground.
3. Neither do we accept the Minister’s second ground, that the AER did not address the substance of the Minister’s submission that in the absence of an efficiency sharing scheme, a DNSP’s incentives for efficiency gains were greater at the start of a regulatory control period.
4. The Minister’s third ground was there may be “non-recurrent factors” equally applicable to all years of a regulatory control period, not just the first two years. Excluding the first two years on that basis, it was submitted, was not logical. However, in our opinion, the AER did not make a reviewable error in identifying risks associated with using data that was no longer relevant and it was not illogical for the AER to decide to use a 3-year historical average. There was no reviewable error in concluding that a three year average was sufficiently long so that the adjustment for corporate overheads was not unduly influenced by non-recurrent factors.
5. We do not accept the Minister’s fourth ground, that the AER asserted that the issue was simply a matter of “judgement”. The AER gave reasons for its conclusion. In our opinion, there was no reviewable error in the AER’s observation that its conclusion was a matter of judgement, in the sense of making a choice between choices available to it. We accept the AER’s submission that the appropriate length of the averaging period was properly understood and described as a matter of judgement, given that there were competing factors at play.
6. We reject the submission that the AER’s approach in this respect was contrary to s 16(1)(d) of the *NEL*. That provision requires the AER, where there are 2 or more possible reviewable regulatory decisions that will or are likely to contribute to the achievement of the NEO, to make the decision that the AER is satisfied will or is likely to contribute to the achievement of the NEO to the greatest degree (referred to in the *NEL* as the “preferable reviewable regulatory decision”). As the Full Court explained in *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79; 345 ALR 1 at [159], in so providing, the legislature is making express, perhaps unnecessarily, the content of what is preferable.
7. In summary, the grounds of review in relation to CitiPower’s and Powercor’s corporate overheads are not made out.

# LABOUR PRICE GROWTH ISSUE

#### Introduction

1. As we have said, CitiPower and Powercor submitted the AER erred in rejecting their proposed labour price growth rate for 2016 based on their existing enterprise agreement outcomes and determining a labour price growth rate for 2016 based on the average of two forecasts of the rate of change in the wage price index for the Victorian electricity, gas, water and waste services (utilities) industry.
2. On 26 August 2016, the Tribunal granted CitiPower and Powercor leave to apply for review in respect of their grounds for review in respect of that matter.
3. At [103] of its application for merits review, CitiPower submitted (omitting footnotes):

CitiPower has two existing EAs:

the ‘Powercor Australia Ltd/CitiPower Pty and CEPU Enterprise Agreement 2013- 2016’, being an EA entered into with the Communications, Electrical, Electronics, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (**CEPU**) and its members, approved on 7 October 2014 (**CEPU EA**);

and

the ‘CitiPower (ASU; APESMA; NUW) Enterprise Agreement 2013’, being an EA entered into with the Australian Municipal, Clerical and Services Union and its members, the Association of Professional Engineers, Scientists, and Managers, Australia and its members and the National Union of Workers and its members, approved on 11 March 2014 (**ASU/APESMAI/NUW EA**).

The CEPU EA sets out bi-annual increases in the base weekly rates of pay for a range of pay points of 2.25 per cent. The increases are specified to occur on 6 May 2014, 1 August 2014, 1 January 2015, 1 July 2015, 1 January 2016 and 1 July 2016. This corresponds with an annualised nominal wage growth rate of 4.55 per cent.

The ASU/APESMAI/NUW EA sets out annual increases in the basic weekly salary for a range of pay points of 4.5 per cent. These increases are effective from the first pay period on or after 1 July 2014, 1 July 2015 and 1 July 2016 respectively.

CitiPower's payroll records indicate that as at 30 November 2015, 56 per cent of employees were employed under its existing EAs.

In addition, the wages (and implied wage growth rates) in the EAs have broader applicability to CitiPower's labour force than employees said to be employed under its EAs.

…

1. Powercor’s application for merits review contained a corresponding statement, at [103] and following.
2. The grounds for review for CitiPower and Powercor were set out at [134]-[138] of their applications for merits review. Given their length, they are best considered as distilled in the submissions made on their behalf.
3. The relevant provisions of the *NER* were as follows:

**6.3.1 Introduction**

(a) A building block determination is a component of a distribution determination.

…

**6.3.2 Contents of building block determination**

(a) A building block determination for a Distribution Network Service Provider is to specify, for a regulatory control period, the following matters:

(1) the Distribution Network Service Provider's annual revenue requirement for each regulatory year of the regulatory control period;

…

**6.5.6 Forecast operating expenditure**

(a) A *building block proposal* must include the total forecast operating expenditure for the relevant *regulatory control period* which the *Distribution Network Service Provider* considers is required in order to achieve each of the following (the *operating expenditure objectives*):

(1) meet or manage the expected demand for *standard control services* over that period;

(2) comply with all applicable *regulatory obligations or requirements* associated with the provision of *standard control services*;

(3) to the extent that there is no applicable *regulatory obligation or requirement* in relation to:

(i) the quality, reliability or security of supply of *standard control services*; or

(ii) the reliability or security of the *distribution system* through the supply of *standard control services*,

to the relevant extent:

(iii) maintain the quality, reliability and security of supply of *standard control services*; and

(iv) maintain the reliability and security of the *distribution system* through the supply of *standard control services*; and

(4) maintain the safety of the *distribution system* through the supply of *standard control services*.

(b) The forecast of required operating expenditure of a *Distribution Network Service Provider* that is included in a *building block proposal* must:

(1) comply with the requirements of any relevant *regulatory information instrument*;

(2) be for expenditure that is properly allocated to *standard control services* in accordance with the principles and policies set out in the *Cost Allocation Method* for the *Distribution Network Service Provider*; and

(3) include both:

(i) the total of the forecast operating expenditure for the *relevant regulatory control period*; and

(ii) the forecast operating expenditure for each *regulatory year* of the relevant *regulatory control period*.

(c) The *AER* must accept the forecast of required operating expenditure of a *Distribution Network Service Provider* that is included in a *building block proposal* if the *AER* is satisfied that the total of the forecast operating expenditure for the *regulatory control period* reasonably reflects each of the following (the *operating expenditure criteria*):

(1) the efficient costs of achieving the *operating expenditure objectives*; and

(2) the costs that a prudent operator would require to achieve the *operating expenditure objectives*; and

(3) a realistic expectation of the demand forecast and cost inputs required to achieve the *operating expenditure objectives*.

(d) If the *AER* is not satisfied as referred to in paragraph (c), it must not accept the forecast of required operating expenditure of a *Distribution Network Service Provider* that is included in a *building block proposal*.

(e) In deciding whether or not the *AER* is satisfied as referred to in paragraph (c), the *AER* must have regard to the following (the *operating expenditure factors*):

(1) [**Deleted**]

(2) [**Deleted**]

(3) [**Deleted**]

(4) the most recent *annual benchmarking report* that has been *published* under rule 6.27 and the benchmark operating expenditure that would be incurred by an efficient *Distribution Network Service Provider* over the relevant *regulatory control period*;

(5) the actual and expected operating expenditure of the *Distribution Network Service Provider* during any preceding *regulatory control periods*;

(5A) the extent to which the operating expenditure forecast includes expenditure to address the concerns of electricity consumers as identified by the *Distribution Network Service Provider* in the course of its engagement with electricity consumers;

(6) the relative prices of operating and capital inputs;

(7) the substitution possibilities between operating and capital expenditure;

(8) whether the operating expenditure forecast is consistent with any incentive scheme or schemes that apply to the *Distribution Network Service Provider* under clauses 6.5.8 or 6.6.2 to 6.6.4;

(9) the extent the operating expenditure forecast is referable to arrangements with a person other than the *Distribution Network Service Provider* that, in the opinion of the *AER*, do not reflect arm’s length terms;

(9A) whether the operating expenditure forecast includes an amount relating to a project that should more appropriately be included as a *contingent project* under clause 6.6A.1(b);

(10) the extent the *Distribution Network Service Provider* has considered, and made provision for, efficient and prudent non-*network* alternatives; and

(11) **[Note: Clause left intentionally blank]**

(12) any other factor the *AER* considers relevant and which the *AER* has notified the *Distribution Network Service Provider* in writing, prior to the submission of its revised *regulatory proposal* under clause 6.10.3, is an *operating expenditure factor*.

…

**6.5.8 Efficiency benefit sharing scheme**

(a) The *AER* must, in accordance with the *distribution consultation procedures*, develop and *publish* an incentive scheme or schemes (*efficiency benefit sharing scheme*) that provide for a fair sharing between *Distribution Network Service Providers* and *Distribution Network Users* of:

(1) the efficiency gains derived from the operating expenditure of *Distribution Network Service Providers* for a *regulatory control period* being less than; and

(2) the efficiency losses derived from the operating expenditure of *Distribution Network Service Providers* for a *regulatory control period* being more than,

the forecast operating expenditure accepted or substituted by the *AER* for that *regulatory control period*.

(b) An *efficiency benefit sharing scheme* may (but is not required to) be developed to cover efficiency gains and losses related to *distribution losses*.

(c) In developing and implementing an *efficiency benefit sharing scheme*, the *AER* must have regard to:

(1) the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme for *Distribution Network Service Providers*;

(2) the need to provide *Distribution Network Service Providers* with a continuous incentive, so far as is consistent with economic efficiency, to reduce operating expenditure ;

(3) the desirability of both rewarding *Distribution Network Service Providers* for efficiency gains and penalising *Distribution Network Service Providers* for efficiency losses;

(4) any incentives that *Distribution Network Service Providers* may have to capitalise expenditure; and

(5) the possible effects of the scheme on incentives for the implementation of non-network alternatives.

(d) The *AER* may, from time to time and in accordance with the *distribution consultation procedures*, amend or replace an *efficiency benefit sharing scheme*.

**6.5.8A Capital expenditure sharing scheme**

(a) A *capital expenditure sharing scheme* is a scheme that provides *Distribution Network Service Providers* with an incentive to undertake efficient capital expenditure during a *regulatory control period*.

(b) If the *AER* develops a *capital expenditure sharing scheme* in accordance with this clause, the *capital expenditure sharing scheme* must be consistent with the *capital expenditure incentive objective*.

(c) In developing a *capital expenditure sharing scheme*, the *AER* must take into account the following principles (the *capital expenditure sharing scheme principles*):

(1) *Distribution Network Service Providers* should be rewarded or penalised for improvements or declines in efficiency of capital expenditure; and

(2) the rewards and penalties should be commensurate with the efficiencies or inefficiencies in capital expenditure, but a reward for efficient capital expenditure need not correspond in amount to a penalty for the same amount of inefficient capital expenditure.

(d) In developing a *capital expenditure sharing scheme*, the *AER* must also take into account:

(1) the interaction of the scheme with other incentives that *Distribution Network Service Providers* may have in relation to undertaking efficient operating or capital expenditure; and

(2) the *capital expenditure objectives* and, if relevant, the *operating expenditure objectives*.

(e) In deciding:

(1) whether to apply a capital expenditure sharing scheme to a Distribution Network Service Provider for a regulatory control period; and

(2) the nature and details of any capital expenditure sharing scheme that is to apply to a Distribution Network Service Provider for a regulatory control period,

the AER must:

(3) make that decision in a manner that contributes to the achievement of the capital expenditure incentive objective; and

(4) take into account:

(i) both the *capital expenditure sharing scheme principles*, and the matters referred to in paragraph (d), as they apply to the *Distribution Network Service Provider*; and

(ii) the circumstances of the *Distribution Network Service Provider*.

…

**6.12 Requirements relating to draft and final distribution determinations**

**6.12.1 Constituent decisions**

A distribution determination is predicated on the following decisions by the *AER* (**constituent decisions**):

(1) a decision on the classification of the services to be provided by the *Distribution Network Service Provider* during the course of the *regulatory control period*;

(2) a decision on the *Distribution Network Service Provider's* current *building block proposal* in which the *AER* either approves or refuses to approve:

(i) the annual revenue requirement for the Distribution Network Service Provider, as set out in the building block proposal, for each regulatory year of the regulatory control period; and

(ii) the commencement and length of the regulatory control period as proposed in the building block proposal;

(3) a decision in which the *AER* either:

(i) acting in accordance with clause 6.5.7(c), accepts the total of the forecast capital expenditure for the *regulatory control period* that is included in the current *building block proposal*; or

(ii) acting in accordance with clause 6.5.7(d), does not accept the total of the forecast capital expenditure for the *regulatory control period* that is included in the current *building block proposal*, in which case the *AER* must set out its reasons for that decision and an estimate of the total of the *Distribution Network Service Provider’s* required capital expenditure for the *regulatory control period* that the *AER* is satisfied reasonably reflects the *capital expenditure criteria*, taking into account the *capital expenditure factors*;

(4) a decision in which the *AER* either:

(i) acting in accordance with clause 6.5.6(c), accepts the total of the forecast operating expenditure for the *regulatory control period* that is included in the current *building block proposal*; or

(ii) acting in accordance with clause 6.5.6(d), does not accept the total of the forecast operating expenditure for the *regulatory control period* that is included in the current *building block proposal*, in which case the *AER* must set out its reasons for that decision and an estimate of the total of the *Distribution Network Service Provider’s* required operating expenditure for the *regulatory control period* that the *AER* is satisfied reasonably reflects the *operating expenditure criteria*, taking into account the *operating expenditure factors*;

…

1. Section 2D of the *NEL* provided as follows:

**2D Meaning of regulatory obligation or requirement**

(1) A regulatory obligation or requirement is--

(a) in relation to the provision of an electricity network service by a regulated network service provider--

(i) a distribution system safety duty or transmission system safety duty; or

(ii) a distribution reliability standard or transmission reliability standard; or

(iii) a distribution service standard or transmission service standard; or

(b) an obligation or requirement under--

(i) this Law or Rules; or

(ia) the National Energy Retail Law or the National Energy Retail Rules; or

(ii) an Act of a participating jurisdiction, or any instrument made or issued under or for the purposes of that Act, that levies or imposes a tax or other levy that is payable by a regulated network service provider; or

(iii) an Act of a participating jurisdiction, or any instrument made or issued under or for the purposes of that Act, that regulates the use of land in a participating jurisdiction by a regulated network service provider; or

(iv) an Act of a participating jurisdiction or any instrument made or issued under or for the purposes of that Act that relates to the protection of the environment; or

(v) an Act of a participating jurisdiction, or any instrument made or issued under or for the purposes of that Act (other than national electricity legislation or an Act of a participating jurisdiction or an Act or instrument referred to in subparagraphs (ii) to (iv)), that materially affects the provision, by a regulated network service provider, of electricity network services that are the subject of a distribution determination or transmission determination.

(2) A regulatory obligation or requirement does not include an obligation or requirement to pay a fine, penalty or compensation--

(a) for a breach of--

(i) a distribution system safety duty or transmission system safety duty; or

(ii) a distribution reliability standard or transmission reliability standard; or

(iii) a distribution service standard or transmission service standard; or

(b) under this Law or the Rules, the National Energy Retail Law or the National Energy Retail Rules or an Act or an instrument referred to in subsection (1)(b)(ii) to (v).

1 See also section 7A(2)(b).

2 The RoLR cost recovery scheme is dealt with under Part 6 of the National Energy Retail Law.

#### What the AER decided

1. The AER’s decision on this issue was as follows.
2. In its Overview of the CitiPower Final Decision, the AER said, at pages 29-30, its forecast of the overall rate of change used to derive its alternative estimate of opex was lower than CitiPower’s estimate over the forecast period. This was due largely to the difference between how the AER and CitiPower had forecast labour price growth over the regulatory control period. The AER said (omitting footnotes):

To forecast labour price growth, CitiPower used wage increases in its existing enterprise agreement until their expiry, and then used Frontier Economics' recommended extrapolation of long term enterprise agreements from a comparator group of service providers. CitiPower’s forecast is higher than ours, which we base on forecasts of growth in the utilities WPI from Deloitte Access Economics and CIE. The reasons for our approach are discussed below (see box 2).

CitiPower identified a number of cost drivers that it considers will require increased opex over the forecast period. We refer to these cost drivers as possible ‘step changes’. Step changes may be for cost drivers such as new, changed or removed regulatory obligations, or efficient capex/opex trade-offs. We typically compensate a network business for step changes only if efficient base year opex, and the rate of change in opex of an efficient service provider, do not already compensate the business for the proposed costs.

CitiPower proposed $23.9 million for step changes in its revised proposal, of which we have accepted $12.8 million. We have included step changes in our final decision opex forecast for the following proposals:

* Customer relationship management system
* Mobile devices
* RIN compliance
* Introduction of chapter 5A.

These step changes relate to the costs of complying with new or changed regulatory obligations or efficient capex/opex trade offs.

1. Box 2, as referred to, was as follows (omitting a footnote):***recasting labour price growth***

Forecast labour price growth is a component of the opex rate of change. We forecast labour price growth as part of our opex forecast to account for changes in prices over time.

To forecast labour price growth, we use the forecast change in the wage price index (WPI) for the electricity, gas, water and waste services industry (the utilities industry).

For these decisions, we have used forecasts of Victorian utilities WPI growth by Deloitte Access Economics (DAE) and the Centre for International Economics (CIE). We consider the average of these forecasts represents a realistic expectation of the cost inputs required to achieve the opex objectives. This is because these forecasts are forward looking, draw on current market information from multiple sources, and account for important drivers of labour price growth (including enterprise agreements).

CitiPower and Powercor adopted a different approach to ours to forecast labour price growth. CitiPower proposed a hybrid forecasting method based on:

* the annualised wage growth rates in its enterprise agreements for the period up until the expiry of those agreements
* the five year historical average enterprise agreement wage growth rate for all privately owned electricity networks as calculated by Frontier Economics for the period after the expiry of its current agreements.

We are not satisfied that CitiPower's forecast of labour price growth represents a realistic expectation of the cost inputs required to achieve the opex objectives because:

* CitiPower's backward looking historic average forecasting approach does not account for the labour market conditions expected to prevail in the forecast period. We note that wage price growth for the utilities industry and the economy as a whole is currently the lowest on record. CitiPower's labour price forecasting approach does not account for the impact this would have on labour price growth over the forecast period.
* CitiPower did not use the same forecasting approach for all years of the forecast period. We consider this hybrid forecasting method would result in an upwardly biased total forecast of labour price growth over the regulatory control period.
* We do not consider compliance with enterprise agreements or section 50 of the Fair Work Act 2009 (Cth) is a regulatory obligation or requirement as defined in section 2D of the National Electricity Law (NEL). The Tribunal recently considered this matter following applications by the NSW/ACT businesses. The AER has sought review of the Tribunal’s decision in the Federal Court.

We also consider that adopting the wage rate increases in an individual firm's enterprise agreements would reduce the incentive to negotiate efficient wages. If a firm is confident that we will use the wage rate increases in its enterprise agreements to forecast price growth then it has no incentive to minimise those wage increases, as they will be passed through to consumers. This outcome would be inconsistent with the ex ante incentive-based regulatory framework under the NER.

1. At pages 34-35, the AER said services were classified as either “direct control”, “negotiated” or “unregulated” services. Direct control services were services were the AER directly controlled prices by setting a revenue cap on the prices a distributor may charge. These services can be further split by “standard control” and “alternative control” services. The AER’s decision on the forms of regulation to apply to standard control and alternative control services was outlined in the following section. Standard control services are services that are central to electricity supply and therefore relied on by most (if not all) customers. Alternative control services are customer specific or customer requested services. Figure 9 summarised the AER’s decision on service classification for CitiPower for the 2016–20 regulatory control period.
2. At pages 23-24 of Attachment 7, the AER said:

We are not satisfied that CitiPower’s forecast of labour price growth reasonably reflects a realistic expectation of the cost inputs or the efficient costs that a prudent operator would require to achieve the opex objectives.

This is because CitiPower's approach of using its current EA and an historical average of other EAs does not account for the broader labour market conditions expert economic forecasters expect to prevail in the forecast period. Further, CitiPower's forecasting approach which uses two sources of forecasts over the 2016–20 regulatory control period is likely to result in an upwardly biased total forecast of labour price growth over the regulatory control period. CitiPower’s forecast is higher than ours, which we base on forecasts of growth in the utilities WPI from Deloitte Access Economics and CIE. Consequently, our forecast of price growth is on average 0.83 percentage points lower than CitiPower’s forecast.

We are satisfied that this approach to forecasting labour price growth reasonably reflects a realistic expectation of the labour price growth faced by a prudent and efficient firm over the regulatory control period. This forward looking approach draws on available current market information from multiple sources, including from enterprise agreements (EAs), on the expected changes to the drivers of labour price.

1. Attachment 7 contained the AER’s discussion of its assessment of forecast labour price growth for CitiPower. That attachment set out more detail about each of the steps the AER followed in developing its alternative estimate. Step 1 was base year choice; step 2 was assessing base opex; step 3 was the rate of change including price growth (including the price of labour), output growth and productivity growth; step 4 was step changes and step 5 was other costs not included in the base year.
2. At page 56 of Attachment 7, the AER said:

As noted above, there are four key reasons why we cannot accept CitiPower's forecast. The first is CitiPower's approach is not forward looking and it does not consider broader labour market conditions. The second is because CitiPower's approach is inconsistent with incentives to promote economic efficiency. The third is because CitiPower's hybrid approach is likely to be upwardly biased. Finally, CitiPower's approach relies on an incorrect interpretation of ‘regulatory obligation or requirement’.

1. An elaboration of these key reasons followed at pages 57-75. At page 75, the AER said:

When we are not satisfied a DNSP's total forecast opex reasonably reflects the opex criteria, the NER require that we develop our own estimate. Given we disagree with CitiPower's proposed rate of change, we must estimate a forecast of labour price growth that reasonably reflects a realistic expectation of the cost inputs that a prudent and efficient operator would require.

1. The AER adopted the same approach in relation to Powercor: see the Overview and the corresponding Box 2 at pages 30-31. Again, the corresponding Attachment 7 contained the AER’s discussion of its assessment of forecast of labour price growth for Powercor.

#### CUAC’s submissions to the Tribunal

1. The Consumer Utilities Advocacy Centre (**CUAC),** now the Consumer Policy Research Centre **(CPRC)**, submitted that the inefficiency of the 2016 wage growth rates provided for in the enterprise agreements (**EAs**) was demonstrated by a comparison with the WPI for all industries, as well as the for the Victorian electricity, gas, water and waste services (utilities) industry wage price index (**EGWWI WPI**), which both CitiPower and Powercor had accepted as an appropriate basis for the forecast for the 2017-20 regulatory years. It was submitted that the CitiPower and Powercor EAs demonstrated stable annual wage growth rates of 4.5%-4.55% from 2011 to and including 2016, while wage price indices across all industries, including the utilities industry, were declining. Adopting the inefficient growth rates provided for in the EAs for the 2016 year would not result in a materially preferable NEO decision as claimed by CitiPower and Powercor. On the contrary, it would undermine the long-term interests of consumers in several ways. CUAC contended that the AER was correct to reject CitiPower and Powercor’s proposed growth rates for 2016 as set out in the EAs, as they were inefficient at the time they were struck. A chart taken from the AER’s Final Decision for CitiPower at page 7-60 compared the average annual wage increase in newly negotiated EAs since 1998. It illustrated the trend in EAs over time for different sectors and for the overall wage price index as measured by the ABS. It demonstrated that the wage price index had declined quite dramatically since 2011 and that specific industries, including the utilities industry, had also tracked downwards albeit with a slight delay. A further chart created for CUAC showed quarterly changes in the ABS data for wage price index and the utilities wage price index since 2008. The ABS trend for all industries showed a declining wage price index since 2008. A simple regression of ABS utilities data indicated a similar trend. However, an examination of CitiPower’s historical EAs from 2011 showed no such decline. The figures were similar for Powercor. While it may have been reasonable to forecast higher than average wage growth in the utilities sector during the period when the 2011 to 2013 EAs were being negotiated, the same could not be said of the period when the 2013 to 2016 EAs were negotiated.

#### The Applicants’ submissions

1. In summary, CitiPower and Powercor submitted to the Tribunal as follows.
2. Their complaint was focused on the rejection by the AER of the forecasts only insofar as they were built on the existing EAs: it was only the forecast for 2016 that CitiPower and Powercor complained of. Although it did have consequences for later years, because later years built on the growth in 2016, there was no complaint, as part of these proceedings, about the percentage growth forecast or the manner in which those forecasts were developed by the AER for the years 2017 through to 2020.
3. Each of the obligations and requirements imposed on CitiPower and Powercor by the EAs to which they were bound was a “regulatory obligation or requirement” within the meaning of s 2D of the *NEL*. The relevant question was whether the EAs (taken as a whole) “materially affect” the provision of electricity network services by Citipower and Powercor.
4. Contrary to the Tribunal decision in *Application by SA Power Networks* [2016] ACompT 11, CitiPower and Powercor submitted there was no requirement for a “direct” or “unique” connection between the EA and the provision of the services. The Tribunal’s decision in *SA Power Networks* was wrong in law. Entry into the EAs was not a simple matter of managerial choice, and the AER erred in fact in so finding. The EAs substantially determined what CitiPower and Powercor’s labour price growth would be in 2016. It was submitted there was no meaningful parallel between EAs and an ordinary contract. It would be wrong to conclude that, because the terms and conditions of an EA were the subject of negotiation, the making of EAs was within the control of management. The making of EAs was governed by the prescriptive regime in Part 2-4 of the *Fair Work Act*. Section 50 of that Act provided that a person must not contravene a term of an EA. The section was a civil remedy provision and exposed the employer to a pecuniary penalty if it contravened an EA.
5. The AER should have, but failed, to give independent consideration to the 2016 regulatory year and there was no impropriety in CitiPower and Powercor challenging only that aspect of the labour price growth decision.
6. The AER’s decision allowed CitiPower and Powercor substantially less than the labour price growth under the EAs. This was said to be an error insofar as the AER allowed an increase of less than the labour price growth under the EAs, as that would be less than the actual labour price growth increases that these entities would face. The increase in the method produced by the AER did not allow for the wage increases in the current EAs.
7. This was an incorrect exercise of discretion because it was based upon a misconstruction of s 2D of the *NEL*.
8. Further or alternatively, the AER exercised its discretion incorrectly because in failing to take account of the labour price growth under the EAs it misconstrued the opex and capex objectives and opex and capex criteria in rr 6.5.6 and 6.5.7 of the *NER*.
9. Further, or in the alternative, CitiPower and Powercor submitted that they acted efficiently and prudently in entering into the EAs and there was no basis to conclude that the EAs did not reflect efficient labour price growth for 2016. The AER instead relied upon “broader labour market conditions” in forecasting CitiPower and Powercor’s labour price growth for 2016. That reasoning was erroneous because “broader labour market conditions” were irrelevant in circumstances where price growth was substantially determined by the EAs.
10. In any event, CitiPower and Powercor submitted, the AER’s measure of “broader labour market conditions”, namely the EGWW WPI was not a good comparator for CitiPower and Powercor, primarily because of the specialised skills of their employees, the Electrical Trades Union (**ETU**) monopoly on the market for supply of skilled electrical services labour, and the vulnerability of CitiPower and Powercor to industrial action by the ETU.
11. The AER erred in refusing to accept CitiPower and Powercor’s forecast labour price growth for 2016 on the basis that this would impact on a DNSP’s incentives to negotiate for efficient labour price growth. There was ample incentive in the regulatory regime for a DNSP to negotiate efficient labour price growth. The AER’s approach, by contrast, distorted incentives by encouraging low labour price growth even in circumstances where that is not the most efficient course overall.
12. CitiPower and Powercor submitted that the AER’s rejection of their forecast labour price growth for 2016 on the basis that it involved a hybrid forecasting method was illogical.
13. The AER wrongly concluded that for CitiPower and Powercor’s forecast not to be upwardly biased, its wage rates would need to be lower than the industry average in 2014 and that none of the evidence suggested that to be the case. There was ample evidence that a downwards efficiency adjustment in 2017 would not be expected.
14. CitiPower and Powercor submitted the AER’s approach was inconsistent because the AER accepted that CitiPower and Powercor were among the most efficient DNSPs in Australia, and adopted their revealed base-year opex as the basis for their opex forecasts, but did not allow CitiPower and Powercor to recover their (efficient) revealed costs of labour escalation under their EAs. Contrary to the AER’s submission, this submission was raised by CitiPower and Powercor before the AER and was not precluded by s 71O of the *NEL*.
15. The AER failed to but should have taken account, in assessing an allowance for 2016 labour price growth, the fact that its forecast of 2017-2020 labour price growth was likely to undercompensate CitiPower and Powercor because it had used downwardly biased estimates of Victorian EGWW WPI.
16. At Attachment A to the submissions of CitiPower and Powercor in reply, they provided an illustrative example of the incentive effects of the efficiency benefit sharing scheme (**EBSS**) on their commercial incentive to minimise labour price growth in negotiating their existing EAs.
17. In oral submissions, CitiPower and Powercor submitted that none of the provisions of the rules were specifically and separately addressed to the subject of labour price growth. Labour price growth fed into the building block proposal as an integer, but it was not an aspect of the rules that something specific had to be done in relation to labour price growth. That was true on a year-by-year basis or in relation to the totals for labour price growth over the 5-year regulatory control period.
18. CitiPower and Powercor submitted that the benchmarking showed that they were the most efficient distributors. One of their fundamental complaints was that, being the most efficient distributors, they were not getting the labour price growth they said was associated with the efficiencies that had been achieved.
19. As to s 2D of the *NEL*, CitiPower and Powercor submitted that the relevant inquiry was not about whether a specific obligation materially affected the supply of electricity, but whether the Act or the instrument materially affected the supply of electricity services. Then there was an inquiry as to whether or not the act or obligation comes under the Act or instrument. That was an important distinction because the AER submitted the relevant obligation was the wage increase and the question then became whether that wage increase materially affected the supply of electricity network services. If that point were reached, CitiPower and Powercor submitted they still succeeded because the payment of wages or a wage increase was something that materially affected the supply of electricity network services. CitiPower and Powercor submitted that the AER was wrong to reason that if anything materially affected the provision of network services (which was denied), it was the DNSP’s own decision to enter into the agreement. CitiPower and Powercor submitted the Tribunal erred in *SA Power Networks* in concluding that obligations under EAs were not regulatory obligations under the Act. If the AER was wrong about “materially affect”, it was necessarily also wrong in concluding that the EBAs or the Act were not associated with the provision of standard control services.
20. In summary, in relation to s 2D of the *NEL*, CitiPower and Powercor submitted that the AER was wrong: in concluding that the EAs or the Act were not regulatory obligations or requirements; in concluding that compliance with the EAs was not an operating expenditure objective, or a capital expenditure objective; in concluding that the costs incurred to comply with the EAs were not consistent with the opex objectives and the capex objectives; and in not including those costs when it made its own estimation of the total required opex and capex. All those errors, they submitted, stem from the misconstruction and the misapplication of the *NEL*, and that error resulted in the applicants receiving a capex allowance and an opex allowance that was less than the amount that is reasonably required to meet the opex objectives and the capex objectives, meaning that the revenue and pricing principles were offended.

#### The AER’s submissions

1. The AER submitted, in summary, as follows.
2. The matter under review was one aspect of the AER’s decision estimating total required opex and capex under r 6.12.1(3)(ii) and (4)(ii) of the *NER*: namely, the labour component of the overall price growth rate for 2016. The asserted error related to its decision to adopt a labour price growth rate for the 2016 regulatory year based on a simple average of the forecasts of the rate of change of Victorian electricity, gas, water, waste services, WPI, prepared by each of the AE and CIE. The challenge was to the AER’s estimate based upon that methodology.
3. The arguments of CitiPower and Powercor proceeded on the premise that the wage increase rate under their EAs was the appropriate escalator to use for the labour price growth forecast, because the EAs applied to a large part of their labour cost. The evidence for that premise was very weak.
4. In response to alleged error 1, that it did not properly construe the *NEL* and the *NER*, the AER submitted the opex criteria did not compel it to include the EA wage increase rate for 2016 in the estimate of required opex or capex. The AER submitted that wage increase obligations under EAs were not obligations or requirements that “materially affect the provision of … electricity network services”.
5. In response to alleged error 2, that its approach involved taking into account irrelevant considerations by taking into account broader labour market conditions in the forecast period (in respect of labour price growth forecast for 2016), the AER submitted that broader labour market conditions were not an irrelevant consideration to the AER’s decision.
6. In response to alleged error 3, that it made a number of errors in taking the view that adopting wage rate increases in an individual firm’s EAs would not provide effective incentives in order to promote economic efficiency through the negotiation of efficient wages, the AER submitted it was not illogical, or otherwise an error, for the AER to consider the impact on efficiency incentives from adopting a service provider’s EA wage rate increase.
7. In response to alleged error 4, that it erred in disagreeing with CitiPower and Powercor’s proposed hybrid methodology for forecasting labour price growth over the regulatory period, the AER submitted it was not illogical, or otherwise an error, for the AER to prefer a single forecast methodology across the regulatory control period, rather than a hybrid methodology.
8. In response to alleged error 5, that its opex decision was internally inconsistent, the AER submitted it did not follow that, because CitiPower and Powercor’s overall opex was benchmarked as comparatively efficient between 2006 and 2014, that the EA wage increase rate for 2016 was necessarily efficient.
9. In response to alleged error 6, that its decision with respect to the 2016 labour price growth rate was likely to under compensate CitiPower and Powercor, the AER submitted CitiPower and Powercor’s arguments concerning under compensation were a statement of conclusion, rather than a statement of error, and related to the years 2017-2020 which were not the subject of review. Requiring an automatic allowance for the 2016 EA wage increase rate would not result in a decision that would promote efficiency for the long-term interests of consumers in a materially preferable way.
10. The AER provided a written response to the illustrative example given by CitiPower and Powercor of the incentive effects of the EBSS.
11. In oral submissions, the AER submitted that the contention by CitiPower and Powercor was that the AER erred when making its own estimate of required opex and required capex and the error was by not adopting the wage increase rates under the EAs for the 2016 year. The applicants did not challenge the immediately preceding decision of the AER not to accept the opex forecast proposed by them and, in particular, they did not challenge the AER’s decision not to accept their labour price growth forecasting method for 2017 to 2020. The AER was considering the proposal put forward by CitiPower and Powercor, which was their combined methodology for the whole period. And that gave rise to some unfairness in the criticism made by them of the AER’s decision. The argument of CitiPower and Powercor must ultimately be that the proper application of the *NER* required the AER to use the EA wage increase rate for 2016, and therefore the AER erred in choosing a different methodology to make its forecast.
12. The AER submitted that the ground of review was that it was wrong to base its estimate on utilities’ wage price index for the whole period. However what the AER was doing was seeking to strike an escalator that was suitable for labour broadly defined, which was more than employees, employees under EAs or total employees, and also included contractors for field work. The AER was seeking to derive a suitable escalator for the labour price growth for that fairly large category. The applicants said the AER was wrong to choose the utilities wage price index. They said that, really, a proper application of the *NER* ought to have led the AER to use the enterprise agreement wage increase rate for 2016. The central argument was that the AER was compelled by the *NER* to use the wage increase rate under the EAs in deriving the labour component of the price growth forecast within the overall opex forecast. It did not necessarily follow that that was the right total escalator for the labour price growth forecast and some further investigation might need to be done as to how far the impacts of the EAs really flowed.
13. The AER submitted that if the applicants’ construction of the legislation was correct, the AER’s ability to assess the efficiency and prudence of a service provider’s labour costs, if those labour costs were incurred under an EA, was substantially reduced. If the wage rates and the wage increase rates under an EA were regulatory obligations, then the effect of these provisions seemed to be that the AER must allow those rates.
14. The AER submitted, with reference to s 7 of Sch 2 to the *NEL*, that the construction of s 2D(1)(b)(v), on which the applicants relied, was not a construction that best advanced the purposes of the law reflected in the NEO. The NEO was advanced if the AER was able to assess the efficiency and prudency of labour costs, regardless of whether they were incorporated into EAs or otherwise. The AER submitted there were two main disagreements between the parties in respect of construction. The first area of disagreement was what do the qualifying words “that materially affects the provision,” actually qualify? Do they only qualify an Act, or do they qualify an obligation or requirement under an Act? The second area of disagreement was what the words “materially affect” meant.
15. As to the first area of disagreement, the AER submitted the definition was concerned with regulatory obligations of a certain kind, plainly, and the purpose of the definition was to define those obligations. Those obligations were defined with some specificity, being obligations that have the characteristics that were set out in each of the sub-paragraphs. Relevantly for (v), it was an obligation or requirement that materially affected the provision by a regulated network service provider of electricity network services. On the applicants’ construction, the obligations were much more at large. It was difficult to discern a statutory purpose for defining regulatory obligations or requirements in the manner for which the applicants contended. In contrast, there was an obvious statutory purpose for defining the regulatory obligations in a more specific manner that pointed attention to specific obligations, being obligations that materially affected the provision by a regulated network service provider of electricity network services.
16. As to the second area of disagreement, the AER submitted it was necessary to identify the relevant obligations under the EA and consider whether the relevant obligations materially affected the provision of network services. The word “material” had an important evaluative role within the paragraph and ought to be given work. Therefore the relevant question was whether the wage increase rate of 4.5 per cent which appeared in the EA for 2016 materially affected the provision of network services. Would there be any material affectation of the provision of electricity network services if the wage increase rate had been, say, 2.5 per cent, 3.5 per cent, 4.5 per cent or 5.5 per cent? The AER submitted there was no reason to draw the conclusion that that wage increase rate had a material effect on the provision of network services.
17. As to other terms of the EAs that the applicants submitted affected the provision of network services, such as provisions relating to tools, or working in adverse weather, and those sorts of matters, a question still arose: was that really material affectation of the provision of network services? In what way, and to what extent, and could it be seen and determined that they necessarily affected the provision of network services? If those provisions were not in the EA, would there be any material difference to the provision of network services? Could it be seen that without those provisions there would be some kind of difference to the provision of network services?
18. It did not follow, the AER submitted, from the obvious fact that labour of some kind was needed by a service provider, that one particular method of engaging the labour materially affected the provision of network services. There was something of a slide from speaking about labour generally being necessary to provide network services, to moving to labour employed under EAs materially affecting the provision of those services. In *SA Power Networks*, the Tribunal was saying that the mere observation of a cost did not logically suggest that the thing under which the cost was incurred materially affects the provision of network services. The obligation for the cost itself was not truly causing a material affectation of the provision of network services.
19. As to the allegations of error in the AER’s reasoning aside from the rules, the applicants’ submission was that broader labour market conditions were not relevant to the labour price growth that the applicants would face for the 2016 year and, therefore, the AER took into account an irrelevant consideration in taking into account that factor: because it was not relevant to 2016, therefore, it was an irrelevant factor.
20. The AER submitted there were at least three difficulties with the argument. The first was that the applicants criticised part of the AER’s reasons that were directed to the whole of the forecasting methodology advanced by the applicants, not merely the 2016 year. The second difficulty with the argument was that it ignored other aspects of the AER’s reasons, why the AER rejected the use of the 2016 wage increase rate, and that particularly related to the hybrid methodology issue which sat over the whole of the rejection of the applicants’ forecast methodology: that was a significant reason why the AER did not agree with the totality of the methodology advanced and splitting the methodology with one approach for 2016 and another for the other years. The third difficulty was that it did not necessarily lead to a conclusion that there was relevant error in the (hybrid) methodology that was ultimately applied by the AER under its own estimate.
21. As to internal consistency, the AER submitted there was no necessary logical relationship between historical opex efficiency and future opex efficiency. Although the AER did determine that CitiPower’s and Powercor’s base year opex in 2014 remained at efficient levels, it was still necessary for the AER to look to the forecast period. It was making a forecast and it needed to make an estimate of the efficient rate of real price growth, one component of which was labour and which had to be applied to the full breadth of labour costs that the AER took into account. It had to form a view about that for the forecasting period. The AER submitted that the mere fact that CitiPower or Powercor was generally regarded as an efficient firm as at the end of the last regulatory period did not provide a sound basis for necessarily concluding that the 2016 wage increase rate in the enterprise agreement was necessarily the efficient level going forward. It may be, it may not be, it was submitted.

#### Further submissions

1. In response to the decision of the Full Court in *Australian Energy Regulator v Australian Competition Tribunal (No 2)*, the following submissions were made by leave of the Tribunal.
2. The CPRC (previously the CUAC) submitted that it was open for the present Tribunal to determine whether EAs were an “applicable regulatory obligation or requirement”, and to do so consistently with the decision in *Application by SA Power Networks*. The decision of the Full Court confirmed that it was open to the Tribunal to examine whether the labour price growth rates contained in network EAs were required to fulfil the opex objective and, if so, whether they reasonably reflected the opex criteria. The Full Court highlighted that this enquiry required an examination of all the facts and circumstances relevant to the EAs in question. The Full Court’s affirmation of the reasoning of the Tribunal that the AER erred in its reliance on the EI model to conclude that the NSW networks’ labour management practices were inefficient and that their EAs were an endogenous managerial choice was not determinative of the present proceedings, which must necessarily turn on the AER’s particular analysis of CitiPower and Powercor’s labour price growth rates. The Full Court confirmed at [371] that, standing alone, the Tribunal’s statement that it was the legislative intention of Parliament that consumers bear the costs of inefficient EAs was incorrect. This supported the CPRC’s contention that the AER was correct to reject CitiPower and Powercor’s proposed growth rates for 2016 because they were based on EAs that were inefficient at the time they were struck. It indicated the relevance of the material contained in CPRC’s submissions dated 6 October 2016 as part of the “facts and circumstances” to be examined by the Tribunal. The Full Court’s decision also left open for the current Tribunal to find that regardless of whether error was established in the AER’s approach, adopting the inefficient growth rates provided for in CitiPower and Powercor’s EAs would not result in a materially preferable NEO decision.
3. CitiPower and Powercor submitted that the Full Court upheld the Tribunal’s finding that it was erroneous for the AER to have concluded that the EAs of the New South Wales businesses under consideration “were an endogenous managerial choice” They referred to pages 7-73 of each Final Decision and submitted that the reasoning of the Full Court confirmed that this approach was too simplistic. While the AER did not expressly adopt the “endogenous/exogenous” dichotomy criticised by the earlier Tribunal, its reasoning was to the same effect. The Full Court’s reasoning supported CitiPower and Powercor’s submissions that it was an error of the AER to regard EAs as the product of managerial choice akin to an ordinary contract. CitiPower and Powercor contended that the AER’s reasoning at each of pages 7-73 was a material error of fact. The finding was also material to the AER’s errors in concluding that compliance with EAs was not a “regulatory obligation or requirement” within the meaning of s 2D of the *NEL*, and that compliance with EAs did not otherwise form part of the opex and capex objectives and criteria.
4. The AER submitted that the decision of the Full Court did not assist in the determination of the grounds of review: none of the findings made by the Full Court supported CitiPower and Powercor’s grounds of review. The “labour cost” issue raised by CitiPower and Powercor before this Tribunal was different to, and much narrower than, the matters which were the subject of consideration by the Full Court.

#### The Tribunal’s analysis

1. We address first the s 2D question. That provision is a definition section. The term “regulatory obligation or requirement” is to be found first in s 7A of the *NEL*:

**7A Revenue and pricing principles**

1. The revenue and pricing principles are the principles set out in subsections (2) to (7).

(2) A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in--

(a) providing direct control network services; and

(b) complying with a regulatory obligation or requirement or making a regulatory payment.

1. Also, the term is relevantly found in r 6.5.6 of the *NER* – Forecast operating expenditure. By that rule, a building block proposal must include the total forecast operating expenditure for the relevant regulatory control period which the DNSP considers is required in order to achieve each of the following (the opex objectives): (2) comply with all applicable regulatory obligations or requirements associated with the provision of standard control services. Then, by s 2D, a regulatory obligation or requirement is defined to be, relevantly, an obligation or requirement under an Act of a participating jurisdiction, or any instrument made or issued under or for the purposes of that Act (other than national electricity legislation or an Act of a participating jurisdiction or an Act or instrument referred to in subparagraphs (ii) to (iv)), that materially affects the provision, by a regulated network service provider, of electricity network services that are the subject of a distribution determination or transmission determination.
2. In the opinion of the Tribunal, on this question of construction, the wage increase rates under the EAs of CitiPower and Powercor are not, by s 2D, made the appropriate escalator to use for the labour price growth forecast. Put differently, neither the revenue and pricing principles nor the opex objectives meant that the AER was required to include the EAs’ wage increase rate for 2016 in the estimate of required opex or capex.
3. The revenue and pricing principles in s 7A(2) do not require that result, if for no other reason than they refer not only to a principle but also to a reasonable opportunity to recover at least the efficient costs of complying with a regulatory obligation or requirement. This means there are evaluative steps involved in taking into account the costs of complying with a regulatory obligation or requirement such that the EAs do not mandate their wage increase rate as the appropriate escalator.
4. We reach the same conclusion in relation to r 6.5.6 of the *NER*, read with s 2D of the *NEL*. We accept that there is an obligation or requirement under an instrument under an Act of a participating jurisdiction, the Commonwealth, but we conclude that the obligation or requirement under the EAs does not materially affect the provision of the electricity network services, within the meaning of s 2D(1)(b)(v) of the *NEL*. While we do not find it necessary to use the language used by the Tribunal, differently constituted, in *SA Power Networks* at [351], that is, the language of “real, direct and tangible connection – one that is not remote”, or at [523] where that Tribunal used the words “unique connection between the EA and the provision of electricity network services”, we consider that any obligation must be regulatory so as to materially affect the provision of the services. In our opinion, the particular wage rate increases under the particular EAs under the *Fair Work Act* are not of that character. In our opinion, the connection between the EAs and the provision of the services is insufficient to answer the description “materially affect the provision of the … services”.
5. In so concluding, we have taken into account the consideration of the nature of EAs in *Toyota Motor Corporation Australia Ltd v Marmara* [2014] FCAFC 84; 222 FCR 152at [88], where the Full Court did not accept the appropriateness of the contractual analogy. Similarly, contrary to the submissions on behalf of the AER, we do not regard as significant any element of choice in entering into an EA, in the present context. We note also what the Full Court said in *Toyota Motor Corporation* at [90]:

An enterprise agreement is a statutory artefact made by persons specifically empowered in that regard, and under conditions specifically set down, by the FW Act. It is enforceable under that Act, and not otherwise. There is, in the circumstances, no reason to approach the question of legislative intent with a predisposition informed by notions of freedom of contract.

1. It follows from what we have so far said that although we do not agree with the reasoning of the AER in relation to the issue of managerial choice, we do not consider that error to have been material. The Tribunal therefore finds that the first error contended for is not made out. For completeness we should add that we do not accept the submission that the AER erred in the manner in which it considered “independently” the 2016 regulatory year. As we read the AER’s reasons, they were directed to the entirety of the regulatory period.
2. Neither do we accept the submission that the AER, as a consequence of its claimed failure to take account of the labour price growth under the EAs, misconstrued the opex and capex objectives and the opex and capex criteria in rr 6.5.6 and 6.5.7 of the *NER*. As the Tribunal understood it, this submission was put in the alternative to the “regulatory obligation or requirement” submission but fails because it is put that “the NEL and the NER, properly construed, require that the Applicants be compensated for the cost of compliance with their respective EAs, including the wage rate increases provided for in those EAs.” In our view there is no such requirement. Contrary to the submissions of the applicants, compliance with EAs is not otherwise required to achieve the opex objective and capex objective of maintaining the safety of the distribution system through the supply of standard control services (rr 6.5.6(a)(4) and 6.5.7(a)(4)), and the cost of compliance with EAs does not reasonably reflect a realistic expectation of the cost inputs required to achieve the opex objectives and the capex objectives (rr 6.5.6(c)(3) and 6.5.7(c)(3)). The AER considered these issues and no error has been made out in that respect.
3. The second claimed error was that the AER erred in relying on “broader labour market conditions” in forecasting labour price growth for 2016. The applicants submitted that broader labour market conditions were relevant for the period after 2016 because there was no EA in place for those years but for 2016 broader labour market conditions were irrelevant. The applicants submitted that what was relevant was to consider the EAs, recognise that they had mandated increases, consider whether they were prudent and efficient and represented reasonable costs, and that was not done: the broader labour market conditions did not really assist in that inquiry, it was submitted. The contention was that the reasoning was erroneous, there was a failure to take into account relevant considerations in relation to 2016, being the EAs and whether they were efficient and prudent and that led ultimately to errors of discretion and unreasonableness.
4. The Tribunal does not accept the premise that “broader labour market conditions” were irrelevant considerations in light of the EAs or at all. In our opinion it was not erroneous reasoning on the part of the AER to say that using the current EA and an average of other EAs did not account for the broader labour market conditions economic forecasters expected to prevail in the forecasting period. Similarly, there is no erroneous reasoning in using forecasts of growth in the utilities WPI from Deloitte and CIE. The AER was making its own assessment of relevant forecasts for the regulatory period and was entitled to consider external benchmarks.
5. The Tribunal does not accept the submission that because broader labour market conditions were not relevant to the labour price growth the applicants faced for the 2016 year therefore the AER taking into account those conditions was the taking into account of an irrelevant consideration. In our view, that could not be so once it is discerned that the AER’s reasons were as to the whole of the forecasting methodology, and were not limited to the 2016 year.
6. We note that, as described by Deloitte Access Economics, its forecasts include data drawn from EAs, for example: “Although EBAs feed into Deloitte Access Economics’ short-term forecasts for wage gains, there are important reasons why EBA data is not the sole driver of utilities wage movements going forward …”.
7. We discern in the submissions on behalf of the applicants a tendency to use the terms “irrelevant considerations”, “relevant considerations” or “erroneous reasoning” or “illogicality” loosely, in circumstances which amounted to no more than disagreement with the AER’s conclusion. We have not dealt separately with each of those submissions.
8. The applicants submitted that it was error on the part of the AER to rely on a Deloitte Access Economics’ opinion that the “electricity” component was a large component of the utilities sector was misplaced as, it was submitted, the Victorian EGWW WPI was not a good comparator for CitiPower and Powercor, primarily because of the specialised skills of their employees. We do not accept there is any reviewable error on the part of the AER in this respect.
9. The third claimed error was put not only as a consequence of the first claimed error but also in the alternative, that alternative being that the AER does have a discretion as to whether or not to accept so much of the opex and capex forecasts as relate to the EAs labour price growth. The applicants pointed to the distortion of incentives that would flow if they were not able to capture their full 2016 EA costs in circumstances where the EAs were efficient when struck. As the argument was put in oral submissions, the point was as follows: the AER said that adopting the wage increase and affirming the EA reduced the incentive to minimise wage growth and this was in effect saying that there was no benefit to negotiating lower wage rate increases because that would have the effect of reducing the revenue allowance at the next reset. That was only true if the DNSP assumed that at the next regulatory reset the AER would not closely scrutinise the EAs that had then been entered into. It was put in submission:

So there’s an irrationality in what the AER is saying. It says that, “We don’t have to accept your EAs at face value. We can scrutinise them. But we’re not going to give you your EA increase on this occasion because you might think that we will automatically allow for that in the next regulatory control period.” But there would be no rational reason for a DNSP to think… like that if it’s true that these things are not regulatory obligations and they can be closely scrutinised by the AER.

1. It was submitted that allowing the applicants the EA wage increases that were struck in 2014 did not send a message to anyone that the AER would not scrutinise future EAs for efficiency.
2. It was also put that the AER’s analysis overlooked the operation of the EBSS and the CESS because they served to incentivise the DNSPs to strike efficient wage outcomes. The applicants submitted that in actual fact the approach that was adopted by the AER served as a disincentive to efficiency rather than the other way round. They submitted that a fair and proper reading of the PwC paper of Mr Balchin did not support, as a matter of logic, the conclusions drawn by the AER.
3. In our view, no illogicality has been established showing an incorrect exercise of the AER’s discretion or that the AER’s decision was unreasonable within s 71C of the *NEL*. The errors alleged go to the merits of the reasoning: they are matters on which reasonable minds may differ but they remain within judgements reasonably open to be made by the AER. We accept the submission that there is nothing illogical in judging that the use of appropriate forecast benchmarks will create incentives for service providers to meet or beat those benchmarks, thereby increasing efficiency over time**.** It was open to the AER to consider that a benchmark approach was suitable to creating appropriate incentives and that it was important to have a consistent approach to a benchmark.
4. The fourth claimed error concerned CitiPower and Powercor’s hybrid forecasting method. The applicants submitted that it was illogical to throw out the 2016 forecasts merely because the same analysis could not be employed for the whole period. This was submitted to be a reasoning and logical error. CitiPower and Powercor accepted that their approach involved utilising one methodology for 2016 and another for 2017 to 2020 but that was a function of the underlying facts and information. In our opinion it has not been shown that there was any reviewable error, beyond a reasonable difference of opinion, in the AER’s approach which was that it was preferable to use one methodology for the entirety of the period. The AER’s single methodology avoided the need to make an adjustment for difficulties arising from using two different methodologies, one for 2016 and the other for 2017-2020. In our opinion, the contention that a known number should be used, with an adjustment, as opposed to a single overall methodology is a dispute about available choices, not rising to reviewable error.
5. The fifth claimed error was one of internal inconsistency. It was submitted to be inconsistent on the part of the AER to accept that CitiPower and Powercor were among the most efficient DNSPs but not to allow them their (efficient) revealed cost of labour escalation under their EAs. We shall assume, with some doubt, that internal inconsistency may give rise to reviewable error, but we are not persuaded that there was such an inconsistency. We see no inconsistency between forming the view that historical opex has been at efficient levels and forming a different view about recent wage increases.
6. The sixth and final claimed error was said to be the likely under-compensation of CitiPower and Powercor by the AER’s use of the Victorian EGWW WPI. It was said that the AER based its forecast of labour price growth on estimates of the Victorian EGWW WPI which it knew were likely to be biased downwards. This was submitted to be the making of one or more errors of fact by the AER in its findings of fact. It was elsewhere and earlier said to amount to illogical reasoning or a failure to take relevant considerations into account, giving rise to an incorrect exercise of discretion or an unreasonable decision.Having considered the applicants’ submissions on this issue, including their reply submissions at [114]-[119], in our opinion the complaint does not rise to the level of reviewable error but rather remains a contention as to the more appropriate index comparator. To submit that the Victorian EGWW is a poor comparator or that another index is an appropriate comparison or appropriate benchmarking does not establish the requisite error.
7. In relation to the decision of the Full Court in *Australian Energy Regulator v Australian Competition Tribunal (No 2)*, it is to be recalled that that decision concerned an application for judicial review of the decision of the Tribunal, the Tribunal being engaged in limited merits review of the AER’s determinations. It was in that context, the context of judicial review, that the Full Court said, at [371], that “it was open to the Tribunal to conclude that the AER committed material errors of fact or (our preferred characterisation) incorrectly exercised its discretion.” We agree with the submission on behalf of the AER that the decision of the Full Court does not directly assist in the determination of the present grounds raised by CitiPower and Powercor. We would however add that the Full Court indicated, at [370], that the Tribunal should examine all the facts and circumstances. This we have endeavoured to do.
8. In summary, none of the claimed errors on the part of the AER in dealing with labour price growth rates has been made out.

# CONCLUSION AND DETERMINATION

1. For these reasons, the Tribunal affirms the reviewable regulatory decisions.

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| I certify that the preceding one hundred and forty-two (142) numbered paragraphs are a true copy of the Reasons for Determination herein of the Honourable Justice Robertson, Mr RF Shogren and Dr DR Abraham. |

Associate:

Dated: 17 October 2017