AUSTRALIAN COMPETITION TRIBUNAL

Application by Envestra Limited [2011] ACompT 13

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| Citation: | | Application by Envestra Limited [2011] ACompT 13 |
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| Review from: | | Australian Energy Regulator |
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| Parties: | | **ENVESTRA LTD (ABN 19 078 551 685)** |
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| File number: | |  |
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| Tribunal: | | **MANSFIELD J (PRESIDENT)**  **PROFESSOR D ROUND**  **MR R DAVEY** |
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| Date of decision: | | 12 October 2011 |
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| Date of hearing: | Heard on the papers | |
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| Place: |  | |
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| Solicitor for Envestra Limited: | Johnson Winter Slattery | |
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| Solicitor for Australian Energy Regulator: | Corrs Chambers Wesgarth | |

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| IN THE AUSTRALIAN COMPETITION TRIBUNAL |  |
|  | ACT 7 of 2011 |

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| RE: | APPLICATION UNDER S 245 OF THE NATIONAL GAS LAW FOR A REVIEW OF An ACCESS ARRANGEMENT DECISION MADE BY THE AUSTRALIAN ENERGY REGULATOR IN RELATION TO ENVESTRA LIMITED PURSUANT TO RULE 64 OF THE NATIONAL GAS RULES |
| BY: | ENVESTRA LIMITED  (ABN 19 078 551 685)  Applicant |

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| TRIBUNAL: | MANSFIELD J (PRESIDENT)  PROFESSOR D ROUND  MR R DAVEY |
| DATE OF ORDER: | 12 OCTOBER 2011 |
| WHERE MADE: | ADELAIDE |

THE TRIBUNAL ORDERS THAT:

1. Leave be granted to Envestra Limited (the Applicant) pursuant to s 245(1) of the National Gas Law to apply to the Australian Competition Tribunal for a review of the applicable access arrangement decision of the Australian Energy Regulator (AER) entitled *Decision: Access Arrangement Envestra Ltd’s South Australian Gas Distribution Network 1 July 2011 – 30 June 2016* published on 7 July 2011 (read together with the reasons for that applicable access arrangement decision, contained in *Final Decision Envestra Ltd Access arrangement proposal for the SA gas network 1 July 2011 – 30 June 2016* published on 17 June 2011) in respect of all grounds specified in Envestra’s application dated 8 July 2011.

THE TRIBUNAL DIRECTS that:

1. The AER file and serve on the Applicant a draft index of all review related matter (Draft Review Related Matter Index) as defined under s 261 of the National Gas Law identifying any matter subject to a claim or claims of confidentiality and the identity of the claimant(s) by 4:00 pm on 13 October 2011.
2. The Applicant request copies from the AER of any documents from the Draft Review Related Matter Index by 4:00 pm on 17 October 2011.
3. The AER provide to the Applicant an electronic copy of any document from the Draft Review Related Matter Index requested pursuant to Order by 4:00 pm on 18 October 2011.
4. The Applicant identify any document it considers should be added to or removed from the Draft Review Related Matter Index and provide the AER with a revised consolidated Draft Review Related Matter Index by 4:00 pm on 20 October 2011.
5. The AER file and serve on the Applicant a revised Review Related Matter Index (Final Review Related Matter Index) identifying any matter subject to a claim or claims of confidentiality and the identity of the claimant(s) by 4:00 pm on 25 October 2011.
6. The Applicant each file and serve on the AER a written outline of submissions in relation to the grounds for review specified in the Applicant’s application by 4:00 pm on 26 October 2011.
7. The Applicant provide to the AER a draft index of the documents the Applicant propose to include in the review book for each ground for review by 4:00 pm on 2 November 2011.
8. The AER file and serve on the Applicant a written outline of submissions in reply to the Applicant’s written outlines of submissions filed pursuant to Order by 4:00 pm on 11 November 2011.
9. By 4:00 pm on 11 November 2011, the AER:
   * 1. provide to the Applicant a list of documents to be included in the review book for each ground for review;
     2. provide to the Applicant an electronic copy of the documents requested for inclusion in review books pursuant to Order 10(a); and
     3. request any copies of review books.
10. The Applicant file and (subject to payment of reasonable printing, copying and collating costs) serve on the AER review books requested pursuant to Order 10(c) in hard copy by 4:00 pm on 16 November 2011.
11. The proceedings be listed for hearing at 10:15 am commencing on 21 November 2011.

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| IN THE AUSTRALIAN COMPETITION TRIBUNAL |  |
|  | ACT 7 of 2011 |

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| RE: | APPLICATION UNDER SECTION 245 OF THE NATIONAL GAS LAW FOR REVIEW OF An ACCESS ARRANGEMENT DECISIONS MADE BY THE AUSTRALIAN ENERGY REGULATOR IN RELATION TO ENVESTRA LIMITED PURSUANT TO RULE 64 OF THE NATIONAL GAS RULES |
| BY: | ENVESTRA LIMITED  (ABN 19 078 551 685)  Applicant |

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| TRIBUNAL: | MANSFIELD J (PRESIDENT)  PROFESSOR D ROUND  MR R DAVEY |
| DATE: |  |
| PLACE: |  |

**REASONS FOR DECISION**

# APPLICATION for leave to review

1. By application dated 8 July 2011, Envestra Limited (the Applicant) seeks leave to apply under s 245 of the National Gas Law (NGL) for a review by the Tribunal of an access arrangement decision made by the Australian Energy Regulator (AER) in respect of the Applicant’s gas distribution network in South Australia. The NGL is set out in the Schedule to the *National Gas (South Australia) Act 2008* (SA) and by s 7 of the *National Gas (South Australia) Act 2008* (SA).
2. The Applicant is a “service provider” within the meaning of s 8 of the NGL as it owns, controls or operates a scheme pipeline. The NGL defines “scheme pipelines” to include “covered pipelines”. The applicants’ gas distribution network is a “covered pipeline” within the meaning of the NGL, pursuant to Item 7 of Schedule 3 of the NGL. The NGL applies in South Australia as the relevant law. Section 26 of the NGL gives the National Gas Rules (NGR) the force of law in South Australia.
3. The AER is responsible for the economic regulation of pipeline services provided by service providers by means of or in connection with a scheme pipeline. In particular, under Part 9 of the NGR, the AER is responsible for determining the total revenue for service providers for each regulatory year of an access arrangement period.
4. Section 132 of the NGL provides that a covered pipeline service provider must submit to the AER for its approval under the NGR, a full access arrangement or revisions to an applicable access arrangement that is a full access arrangement, in respect of the pipeline services that the service provider provides or intends to provide.
5. Under Rule 52 of the NGR, the Applicant was required to submit, and did submit, access arrangement revision proposals for the relevant access arrangement period to the AER for consideration. The Applicant’s proposal was submitted on 1 October 2010 for the period 1 July 2011 to 30 June 2016 (the Applicant’s Access Arrangement Proposal).
6. Under Rule 59 of the NGR, the AER was required to make, and did make in February 2011, an access arrangement draft decision with respect to the Applicant’s Access Arrangement Proposal (Draft Decision).Rule 60 of the NGR entitled the Applicant to submit additions or other amendments to the Applicant’s Access Arrangement Proposal to address the matters raised in the Draft Decision. The amendments which the Applicant was permitted to make were limited to those amendments necessary to address matters raised by the AER in the Draft Decision, unless the AER approved further amendments.
7. On 24 March 2011, the Applicant submitted revised access arrangement proposals to the AER (the Applicant’s Revised Access Arrangement Proposal).
8. Pursuant to Rule 62 of the NGR, the AER was required to make an access arrangement final decision in relation to the Applicant’s Revised Access Arrangement Proposals. Rule 62 of the NGR provides that an access arrangement final decision is a decision to approve, or refuse to approve an access arrangement proposal. Pursuant to Rule 64(1) of the NGR, if in an access arrangement final decision the AER refuses to approve an access arrangement proposal, the AER must itself propose revisions to the access arrangement for the relevant pipeline.
9. On 17 June 2011, the AER published an access arrangement final decision with respect to the Applicant’s Revised Access Arrangement Proposal, entitled *Final Decision Envestra Ltd Access arrangement proposal for the SA gas network 1 July 2011 – 30 June 2016* (Final Decision). The AER by the Final Decision refused to approve the proposal and indicated it would publish its own revised access arrangements and information.
10. Pursuant to Rule 64(4) the AER on 7 July 2011 published its decision giving effect to its own proposed revisions with respect to the access arrangements, entitled *Decision: Access Arrangement Envestra Ltd’s South Australian Gas Distribution Network 8 July 2011 – 30 June 2016* (the Access Arrangement Decision).
11. The applicants seek review of the Access Arrangement Decision (Reviewable Decision) as read with the reasons for the Final Decision.
12. The proposed application for review relates to that part of the Reviewable Decision as concerns:

(a) the Network Management Fee;

(b) the Debt Risk Premium;

(c) the Market Risk Premium; and

(d) the Unaccounted for Gas Quantity Allowance.

The grounds for review are specified in the application.

1. The AER has indicated that it does not oppose the granting of leave to apply for review in relation to the grounds advanced by the Applicant.
2. Section 245 (1) of the NGL provides:

An affected or interested person or body, with the leave of the Tribunal, may apply to the Tribunal for a review of a reviewable regulatory decision.

1. The Applicant is clearly a service provider and is therefore an “affected or interested person or body” within the meaning of s 245.
2. The NGL provides that a “reviewable regulatory decision” includes an “applicable access arrangement decision” (other than a full access arrangement decision that does not approve a full access arrangement): s 244 of the NGL. A “full access arrangement” means an access arrangement that provides for price or revenue regulation as required by the NGR and deals with all other matters for which the NGR require provision to be made for in an access arrangement: s 2 of the NGL. The Reviewable Decision has that character.
3. That is because an “applicable access arrangement decision” is defined in s 2 of the NGL to include a decision of the AER under the NGR that “makes a full access arrangement…in place of a full access arrangement [proposed by the Applicant] the AER does not approve in that decision” or “makes revisions to an access arrangement in place of revisions submitted to the AER under s 132 that the AER does not approve in that decision.”
4. Consequently, the Reviewable Decision is a “reviewable regulatory decision”. It was a decision to “make a full access arrangement” in place of a full access arrangement the AER did not approve. Further, the Reviewable Decision as formulated with regard to the AER’s reasons contained in the Final Decision resulted in “revisions to an access arrangement…in place of revisions submitted to the AER…that the AER does not approve”.
5. Section 246 of the NGL specifies the grounds upon which a decision of the AER may be reviewed. In brief, the grounds are that the AER has made a material error of fact, incorrectly exercised its discretion and/or that its decision was unreasonable.
6. There are two relevant limitations on the Tribunal’s discretion to grant leave to appeal from a decision of the AER.
7. *First,* s 248 of the NGL specifies that the Tribunal must not grant leave to review the AER’s decision “unless there is a serious issue to be heard and determined as to whether a ground for review set out in s 246(1) exists”. The Applicant submitted that the Tribunal might not follow the approach adopted by the Tribunal in its earlier decision in *Application by ElectraNet Pty Ltd* [2008] ACompT 1 (*ElectraNet*) in relation to s 248. That is said to depend upon the threshold imposed under s 248, as interpreted in that case. The Tribunal agrees that the test imposed by s 248 is not a particularly onerous one, and that it requires the Applicant to show that there is a sufficient prospect of success to justify in the circumstances it being given the opportunity to have the Reviewable Decision reviewed by the Tribunal. The Tribunal as presently advised does not regard *ElectraNet* as imposing any more complex or refined test than the ordinary words used in s 248. In the absence of full argument, the Tribunal does not consider it necessary or appropriate to embark upon any further analysis of the reasons in *ElectraNet* in that regard. In this matter, the AER does not dispute that the threshold imposed by s 248 is satisfied.
8. *Second,* s 249 applies (as here) if the leave that is sought under s 245 is about an error in a full access arrangement decision and the ground for review relates to the amount of revenue that may be earned by the service provider. In that event the Tribunal cannot grant leave to review the AER’s decision even if there is a serious issue to be determined unless “the amount that is specified in or derived from the decision exceeds the lesser of $5 million or 2% of the average annual regulated revenue of the … service provider”.
9. Whether the financial threshold in s 249 is satisfied with respect to an application is determined by reference to the cumulative effect of all the errors alleged with respect to that application: *Application by Energex Limited (No 4)* [2011] ACompT 4 (*Energex*)at [52]. The reasoning in *Energex* was adopted in *Jemena Gas Networks (NSW) Ltd (No 2)* [2011] ACompT 5, where the Tribunal found that the aggregate value of Jemena Gas Networks’ grounds of review that met the serious issue threshold exceeded the financial threshold test.
10. The Applicant has set out in its application the grounds upon which it relies to have the AER’s decision set aside. The application seeking review of the decisions of the AER was made within time: s 247 of the NGL.
11. The grounds for review referred to in the application relate to four matters dealt with by the AER in the Reviewable Decision. The first matter raised is in respect of the Network Management Fee (NMF) and incentive payments. The NMF and incentive payments are paid by the Applicant under an outsourcing arrangement with the APA Group, as part of the forecast operating expenditure. The AER did not allow those payments in its operating expenditure forecasts.
12. The Tribunal is satisfied that there are serious questions to be tried as to whether the AER’s Reviewable Decision in that regard involved factual errors, or an incorrect or unreasonable exercise of its discretion under Rule 91(1) of the NGR, or that it misapplied Rule 91(1) according to its terms, or that it gave proper weight to and properly considered evidence about the costs and benefits associated with the outsourcing arrangement. The detailed submissions of the Applicant are set out in its submission at [39] to [42]. In view of the position of the AER, it is not necessary to canvass them in detail.
13. As to the second matter, the Debt Risk Premium (DRP), in the Tribunal’s view there is a serious issue to be determined that grounds of review under s 246(1) exist in relation to it.
14. The AER in the Reviewable Decision has estimated the DRP based on an average of the Bloomberg fair value estimates (extrapolated to a maturity of 10 years) and the observed yields from the APA Group bond resulting in a DRP of 3.81%. Envestra’s proposal was a DRP of 4.67% based solely on the Bloomberg fair value estimates (extrapolated to a maturity of 10 years).
15. The submissions of Envestra provide a sufficient basis for arguing that the AER’s discretion was incorrect, or unreasonable, to satisfy the Tribunal in terms of s 248 of the NGL. As the AER does not oppose the grant of leave, it is necessary to refer to the submissions only briefly. Rule 87(1) of the NGR requires the rate of return on capital to be commensurate with prevailing conditions in the market for funds and the risk involved in providing reference services, and Rule 74(2) requires that its forecast or estimate represent the best forecast or estimate possible in the circumstances. There are arguable grounds for the proposition that the APA Group bond was not an appropriate basis for achieving that outcome, and that the Bloomberg fair value estimates provided such a basis. The adoption of the Bloomberg fair value estimates is reflected in the decision of the Tribunal in *Application by Actew AGL Distribution* [2010] ACompT 4 and *Application by Jemena Gas Networks (NSW) Ltd (No 5)* [2011] ACompT 10.
16. As to the third matter, the Market Risk Premium (MRP), the Tribunal is similarly satisfied that the test in s 248 is met so that it also gives rise to grounds of review under s 246(1).
17. Envestra proposed an MRP in the range of 6.5% to 8%, whereas ultimately in the Reviewable Decision, the AER applied an MRP of 6%.
18. For reasons similar to those concerning the DRP, there are arguable grounds for Envestra contending that the AER’s discretion to fix the MRP at 6% was incorrect or unreasonable in the circumstances, having regard to Rules 87(1) and 74(2) of the NGR. The AER had apparently previously adopted an MRP of 6.5% in decisions prior to the Access Arrangement Decision. There is room for significant debate about whether prevailing conditions in the market for funds have returned to pre-global financial crisis levels. There is also room for debate about whether the evidence before the AER justified the conclusion which it reached, or in some respects carried the weight the AER attributed to that material. Envestra has identified other evidence which is capable of supporting a higher MRP which the AER appears to have discounted.
19. Hence, Envestra seeks to review the Reviewable decision to apply a DRP for calculating the cost of debt of 4.67% and to apply an MRP for calculating the cost of equity of 6.5%. The Tribunal is satisfied that its contentions about those matters raise serious issues to be tried.
20. The final matter raised concerns the claim by the Applicant for an allowance for unaccounted for gas costs (UAFG) in its forecast operating expenditure. Rule 91(1) of the NGR provides how operating expenditure should be allowed for, limited by Rule 40(2).
21. Initially, the AER required the Applicant to reduce its claim for UAFG costs by reducing its forecast UAFG prices and volumes. Although there is no longer an issue about the proposed UAFG price assumptions, the Reviewable Decision reduced the UAFG volumes forecast by the Applicant and so reduced the operating expenses forecast.
22. The Applicant has satisfied the Tribunal that there is a serious question to be tried in that the AER decision concerning the UAFG volume forecast as reflected in the Reviewable Decision was incorrect or was unreasonable. It contends that there was significant evidence that its UAFG volume forecasts were the best estimates arrived at on a reasonable basis, and that the evidence relied upon by the AER was flawed and was itself based on incorrect data. Again, having regard to the position adopted by the AER, it is not necessary to further address those issues.
23. Based upon the evidence of Ms Smith in her affidavit of 8 July 2011, and the submissions, the financial threshold imposed by s 249 is also satisfied. The AER accepts that. The application was made within time. There are no other grounds to decline leave to review the Reviewable Decision which arise under s 250 or 251.
24. Accordingly, the Tribunal gives leave to the Applicant under s 245(1) of the NGL to apply to the Tribunal for a review of the Reviewable Decision in relation to the NMF, DRP, the MRP and the UAFG matters addressed in that decision.
25. In the event of such leave being granted, the parties are agreed upon the directions to be given for the hearing of the review. They are incorporated into the orders of the Tribunal.

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| I certify that the preceding thirty-nine (39) numbered paragraphs are a true copy of the Reasons for Decision herein of the Honourable Justice Mansfield (President), Professor D Round and Mr R Davey. |

Associate:

Dated: 12 October 2011