Opinion

The Centre for independent Studies [CIS] seeks to be advised as to whether the Australian Energy Regulator [AER] and or the Australian Energy Marketing Organisation [AEMO] have acted in a way that is either unlawful or extra-legal in the approach adopted by those two bodies in relation to two proposed developments and extensions to the electricity grid respectively known as HumeLink and VNI West together amounting to an investment to be paid for by the consumers of the electricity so produced of some AUD 9 billion.

Before embarking on an answer to the question of the lawfulness of the decision it is necessary first to identify the several organisations and bureaucratic procedures involved in the decision making process and to identify the statutory provisions which govern the decisions that have been made.

The Legislative Framework

National Electricity Law [NEL]
National Electricity Rules [NER]

The Relevant bodies and projects

AEMC
AER
AEMO
ISP
IASP
ODP
CPA
RIT-T
Actionable ISP Project
FBPG
AER Compliance & Enforcement Policy
Transgrid HumeLink
Transgrid VNI West

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Central to the complaint is the assertion that notwithstanding a mandatory obligation to consult imposed by the NER, the AER failed to ensure that AEMO complied with that duty, asserting that it was invested with a discretion to waive enforcement of the duty of consultation imposed on AEMO, which discretion it exercised in favour of the proposed projects, viz; Transgrid HumeLink and Transgrid VNI West. This is said to be a dereliction of its duty to enforce the NEL and both the relevant NER as well as the mandatory Guidelines which it had itself promulgated [the FBPG].

CIS asks to be advised as to whether such a right of waiver can be found either in the National Electricity Law [NEL] or Rules [NER] which govern the activities and decisions of each of the governmental bodies AER and AEMO and the rule making body, AEMC.

The Question at Issue

The question at issue arose in this way:

- Staff at CIS first had their attention drawn to the matter by the report of the Consumer Panel on the Draft 2022 ISP, who wrote: *"However, our understanding is that the effect of AEMO's decision on TransGrid's feedback loop request is that the staging approach and scope of early works set out in the Draft ISP is now locked-in with no scope for AEMO to make changes based on stakeholder feedback to the Draft ISP. If so, that appears to be a significant weakness in the ISP framework. "*
- This alerted CIS to the significance of skipping consultation on an ISP update to the interests of consumers. Examination of the NER identified the relevant section of the Rules (5.22.15(c)) where it was clear that the consultation was a requirement in the rules.
- The instruments issued by AEMO (both the Update to 2020 ISP, and the Feedback Loop notice for HumeLink's Early Works) made clear the arguments put forward by AEMO for skipping this consultation. The arguments that consultation on the IASR and Methodology were a sufficient substitute for the mandated consultation appeared to be defective on a clear reading, given that they did not contain reference to or consultation about the ODP, which the rules specifically required.
- AEMO issued a notice via email to subscribers for ISP updates on 17 November 2023, foreshadowing the intention to replicate the same apparently defective process, skipping consultation on the ISP update accompanying the Draft 2024 in order to advance the Feedback Loop process for HumeLink and VNI West. This notice also mentioned that AEMO had consulted with AER in this matter, implying knowledge or

consent had been given by AER. No provision is to be found in the rules for AER to consent to any waiver of the consultation process.

- CIS made a submission to the AEMC on the "Improving Workability of the Feedback Loop" rule change request, which had been requested by Minister Bowen, and would seem to have the effect of permanently removing the opportunity for consultation on the ODP that is used for Feedback Loop notices, by allowing a draft ISP to be used in the place of a final ISP for these notices. CIS registered a strenuous objection on the basis that this loss of transparency and accountability would severely impact consumer interests.
- CIS then issued a press release and disclosed the FOI-obtained documents from AER. While heavily redacted, these showed a long history of meetings between AEMO and AER regarding the process of skipping consultation on the update and issuing Feedback Loop notices based on the updated ISP to advance Humelink. Reporting in The Australian on 31 January 2024 quoted Clare Savage claiming that *"there's no point having additional, duplicative processes just for the sake of it..."* which indicated in the view of CIS a flawed understanding of the mandated consultation process that had been waived.
- Senators questioned Clare Savage before Senate Estimates on 12 February 2024 on the matter, eliciting repeated claims from the AER *"it is within our right to do that under the law"*. The relevant portions of that examination are reproduced in this opinion [*infra*].
- CIS has now sought advice as to whether the AER did indeed have a right of waiver, at broadly contemporaneously with it putting in a substantial submission on the Draft ISP. It is the belief of CIS that critical flaws in the cost-benefit-analysis used to justify the advancement of HumeLink at the schedule identified in the Feedback Loop notice has been demonstrated. Hence it seeks advice as to whether the AER as regulator might be able to exercise discretion that has the effect of nullifying any impact of its submission on the actual progression of these crucial transmission investments through the regulatory process or extinguishes on an ad hoc basis the obligation of consultation as a necessary precondition to approval.

<u>The Senate Proceedings</u>

The chair and various executives of AER were called before the hearing of the Senate Environment and Communications Legislation Committee on 12 February 2024. The chair of AER, Ms Clare Savage was challenged about the transparency and accountability of AEMO and of AER as the regulator.

In the course of the hearing it was suggested to Ms Savage that as regulator AER had broken and ignored NER Rule r.5.22.15(c).

That rule provides that AEMO **must** consult on the new information and impact on the Optimal Development Path [ODP] and under the Integrated System Plan [ISP] in accordance with consultation requirements set out in the forecasting best practise guidelines [FBPG] for an ISP update.

The challenge by senator Van was that AEMO has broken the national energy rules [NER] and AER has waived those breaches on two separate occasions, relating to the Transgrid projects already referred to.

By way of response Ms Savage asserted to the Senate committee first that the consultation requirements for an ISP update were less than the requirements for an ISP itself and further, that the consultation undertaken for the 2024 draft ISP was more than was required for an ISP update and that to do the consultation process again as required by the rules would have been duplicative.

In that context Ms Savage asserted that the AER was invested with a discretion which was *our right to do that under the law and it is our guidelines that they would be needing to comply with.*

In order for this controversy to be properly understood it is necessary to set out the exchange as recorded in the Hansard:

Senator Van: It's good to see you again, Ms Savage. Thank you for being here tonight. You'll remember that at last estimates I had some questions on the transparency and accountability of AEMO. I've got some similar questions for you tonight. For those following along at home, I'll just explain the alphabet soup that we'll be diving into. AEMO is the market and system operator. The AEMC, Australian Energy Market Commission, is the rule-making body, and the AER, the Australian Energy Regulator, is the enforcement body. Am I on the money with all those three?

Ms Savage: You are. We do market monitoring, compliance and enforcement, and we're also the economic regulator of the monopoly infrastructure.

Senator VAN: Thank you for confirming that. I'm concerned that AEMO have broken the National Electricity Rules and the AER have waved that through and let that occur on two separate occasions. Are you aware of those two occasions?

Ms Savage: I think you'd have to tell me what rules you think they've broken.

Senator VAN: Sorry. It would be rule 5.22.15(c), where it says:

> AEMO must consult on the new information and the impact on the optimal development path under the Integrated System Plan, in accordance with the consultation requirements set out in the Forecasting Best Practice Guidelines for an ISP update..”

The issue as developed was the failure to consult as required by the rules especially in relation to the ODP including stakeholders thus denying consumers or other market participants make any contribution by consultation as to the output. The Chair of AER continued by asserting

Ms Savage: … Now, the consultation requirements for an ISP update are actually less than the consultation requirements for the ISP itself, and so, in developing a draft integrated system plan, AEMO has to develop the inputs, assumptions and scenarios report, along with some of their methodology documents, and that goes through quite extensive consultation. On both of those occasions, in 2021 and again in 2023, AEMO was about to release the draft ISP, and the consultation that they'd undertaken for that draft ISP was more than what they would have been required to do for an ISP update. In both of those occasions they wrote to us and said, 'Look, we think that consultation process has been done,' and we wrote back and said, 'Yes, we acknowledge that you have done that consultation process,' because to do it again would have been the same process, essentially, but duplicative. And it is within our right to do that under the law, and it is our guidelines that they would be needing to comply with.

Senator VAN: But the difference between the draft ISP, or final ISP, and the IASR is that the IASR is modelling and consulting on inputs into the system, whereas the ISP is about the output, what the optimal development path is. They are two completely different things. By waving through the rule where it says 'AEMO must consult,' you're not letting consumers or any other market participants have any input on what the output of it is. Yes, they've done some consultation on the input, but that's a lot different to the output.

Senator Van pointed out to Ms Savage that:

…To be on the optimal development path and to be at a reasonable cost—and I should pause at this point and point out to those following at home that they're the ones who will be paying that $4.9 billion at the end of the day when you regulate that as part of Transgrid's regulated asset base. This is no small thing; this affects customers all the time. As we heard earlier, some of this funding is coming from the CEFC—seeding some of this money. We're talking about huge sums of money here that people have been denied a chance to have their say on. The draft 2024 ISP not only puts in that new cost but somehow the net market benefit of that went up by, let's guess, the same billion dollars. How can you not let people comment when things like that are sliding through?

This issue was also raised by Senator Cadell later in the hearing:

Senator CADELL: No problem. In the same speech you quoted the Hayne royal commission into banking. The quote was:

> *Compliance with the law is not a matter of choice. The law is … coercive and its coercive character can be neither hidden nor ignored. Negotiation and persuasion, without enforcement, all too readily leads to the perception that compliance is voluntary. It is not.*

How does that quote relate to the energy sector? Given the option *and the wave through of the rules of the AEMO thing, how can we be talking about enforcement and coercion being strong, yet still do wave throughs?*

Ms Savage's response was again to assert that the rules did not bind her:

Ms Savage: I think, from our perspective, there is always the opportunity—and **the law and the rules give us the ability to do this. When we're talking about the approach we took with AEMO, that was not actually the law or the rules per se. It was our guidelines.** So these are our own guidelines, and there's always a practicality element. I would say to you that, when you're looking at a range of activities in the market, you're looking at the level of harm, you're looking at the nature of the breach and the organisation that's involved and you're trying to ensure that you're sending a general deterrence message, a specific deterrence message. So there's quite a range of compliance and enforcement factors that we consider when we look at the question of a potential breach.

In the case that's being to referred to here: (a) we've not formed a view that there has been a breach. We would have to do an investigation. We'd have to look at it and substantiate it. There's a bunch of stuff that you'd need to do, like get legal advice—

Senator CADELL: Is that happening? Are you looking at it?

Ms Savage: We've gone back to AEMO and said that we believe that to have undertaken the same consultation process at the same time would be duplicative and inefficient, and **we have the right to do that under the law.**

Senator CADELL: You have the right to do that, but, in sitting behind you, Mr Andrew Dyer's consultation process says 92 per cent of people are unsatisfied with the consultation. Isn't less consultation bad?

Ms Savage: No. That consultation is critical, but that consultation happens through the regulatory investment test process, not through a feedback loop

process. The feedback loop consultation occurred—I would be very concerned if the feedback loop consultation process hadn't occurred—but we were satisfied that ostensibly exactly the same and, in fact, more detailed consultation was done than what is required in an ISP update. I'm sure you would expect us as a taxpayer to make sure that we were not duplicating consultation for consultation. So that was a higher standard than would have been applied in an ISP update.

This is said by CIS to amount to an impermissible arrogation by AER of a discretion to disregard the legislative framework and Rules that bind both AEMO and AER as the regulator and enforcer of the legislation. Moreover it claims that such a failure to comply with its legislative duty is a breach of trust by the regulator.

The question that arises is; has AER the discretion it claims to disregard the operation of the Act and Rules, in particular r.5.22.15C. and the mandatory provisions of its own Best Practice Guidelines [FBPG].

The complaint by CIS

CIS is a body which has a strong public interest imperative. As such it monitors, considers and evaluates the conduct of public bodies including regulators such as AER and AEMO and as well undertakes consideration of matters of compliance with the law.

In that context it has reviewed the approach adopted by AER in relation to the ISP Update released by AEMO in December 2023 and its compliance with the NER. That consideration and review has led directly to the advice sought. It is as follows:

> On 15th December, AEMO published an update to the 2022 Integrated System Plan (ISP), effectively replacing the document with the unscrutinised 2024 Draft ISP. This was in breach of the National Electricity Rules 5.22.15 c), which required a minimum 30-day consultation for such an update. FOI documents reveal lengthy consultations between AEMO and the AER, making it clear that the breach - *and its sanction by the regulator* -was comprehensively planned and choreographed by the two entities in secret meetings, the content of which have been withheld even from the FOI documents.
>
> **Why does this breach matter?**

Because it allowed AEMO to effectively green-light $9billion of capital investment being passed on to the consumers. It is likely to be the largest single action in terms of impact on consumer bills for the energy transition. This was done by issuing 'feedback loop' notices to HumeLink ($5bn) and VNI West ($4bn) on December 21 2023 confirming they fit with the 'latest ISP', which in this case was the 2022 ISP that had been improperly updated.

Would anything have actually changed if the update (and breach) didn't occur?

Yes, since in the 2022 ISP HumeLink was only assessed as having net benefits of $1.3billion, and has since experienced a cost blow-out of $1.6billion. Without the update, HumeLink would likely not have been 'actionable' at the new price, and either postponed or cancelled. The Draft 2024 ISP claims nearly another billion dollars worth of benefits are now attributable to HumeLink, keeping it actionable in the ODP - *despite* the higher cost. This demands close scrutiny of the Draft 2024 ISP, scrutiny which has now been avoided.

Wasn't this just 'additional duplicative processes' as the Chair of AER claimed?

No, the consultation is the *only* consultation where the 'Optimal Development Path' (ODP) -the key *output* of the entire ISP process - could be scrutinised. Consultations on the *inputs*, such as the IASR and Methodology documents, don't replace consultation on the final output, which is the ODP. Arguing otherwise is akin to saying that a cooking competition can be judged by the chef's description of the recipe and review of the raw ingredients on the bench - that actually tasting the dish on completion is 'additional duplicative processes'. Consulting on the final product is the only step that cannot be skipped.

The Act contains provisions for challenge to both decisions and the exercise of such discretions as are claimed by AER by persons whose interests are adversely affected by the decision, either under section 70 of the NEL or under the provisions of the AD(JR) Act (Commonwealth) for the purposes of testing decisions of the kind about which this advice has been prepared.

<u>The Draft 2024 ISP</u>

- The Draft 2024 ISP maintains that HumeLink and VNI West both remain 'actionable' and part of the ODP. The Cost Benefit Analysis outlined in Apendix 6 of the Draft ISP are crucial in supporting those claims.

- In the 2022 ISP, advancing HumeLink to meet the earliest in-service date was only claimed to have approximately $1.3billion in net benefits. But the project has since faced a cost increase of approximately $1.6 billion dollars. A reasonable person would expect that the net benefits of advancing the projects as planned would be negative, giving rise to the delay or cancellation of the project.
- In the Draft 2024 ISP, the cost benefit analysis for HumeLink that finds the project still has approximately $1billion dollars of net benefits, but this is obtained by modelling it being completed in 2029-30, three years later than in the previous ISP, and also three years later than the schedule being approved by the Feedback Loop notice. This timing of the modelling is clearly preferable in terms of net economic benefits than the timing approved in the Feedback Loop Notice, because it aligns with the completion of Snowy 2.0, VNI West, the Central West Orana REZ, none of which would be available to utilise the capacity of HumeLink in 2026-27.
- For this reason, along with many other reasons outlined in the CIS submission, it is clear that the completion of proper consultation on the Draft 2024 ISP is crucial to the outcome of the Optimal Development path, and particularly the status of HumeLink and VNI West. Omitting consultation runs strongly counter to the interest of consumers, as a substantial over-investment in transmission appears to be imminent, based on flaws in the Draft 2024 ISP. It is precisely this that the consultation process contemplated by the FBPG is designed to eliminate.

<u>The asserted duty to consult and the FBPG.</u>

There can be no doubt that the NEL and NER together provide a scaffold within which AER and AEMO are required to operate and with which they each are required to comply. The rule under consideration [r5.22.15C] is not a stand-alone provision but lies within Part D of Chapter 5 of the NER, which deals with the planning and expansion of networks and the national grid. Consultation is mandated throughout Chapter 5 and the Rules make specific provision for different types of consultation in varying contexts. In the context of the present proposed projects, R 5.16A.5 requires a series of criteria for a 'trigger event' to be satisfied.

Among these is identified need specified in the "most recent Integrated System Plan" [ISP]. In turn r5.22.6 requires that AER must include in the forecasting best practise guidelines guidance for AEMO's forecasting practises and processes as they relate to an integrated system plan and the process including consultation requirements for an ISP update

That rule further provides that AER may specify parts of the forecasting best practise guidelines relevant to the ISP that are binding on AEMO. Reference to the forecasting best practise guidelines themselves make's clear that AER has specified those parts and that they include compulsory consultation of a kind not undertaken in the present projects because AER has chosen to waive compliance with the FBPG for the relevant Draft ISP despite r.5.22.15(c).

That rule is expressed in terms which admit of no discretion to waive its operation. Relevantly it provides:

> …. *AEMO **must** consult on the new information and impact on the Optimal Development Path [ODP] and under the Integrated System Plan [ISP] in accordance with consultation requirements set out in the forecasting best practise guidelines [FBPG] **for an ISP update.***

Thus 2 elements at least must be complied with, viz; consultation, in accordance with the FBPG; and for an ISP **update**.

In the present matter no issues arises in relation to there being an ISP update - see Ms Savage's evidence to the Senate Committee set out above.

The FBPG set out clearly the authority under which they are promulgated and operate:

1.1 Authority

... NER clause 5.22.5(j) allows us to specify which parts of the FBPG are binding on AEMO… this clause applies to components of the FBPG that relate to the ISP...

- binding requirements by words in italics *required or requirement*
- binding considerations by words in italics *must have regard to or must consider*...

by FBPG 2.2 AEMO is *required* to follow the single stage process in Appendix B when developing consulting on and publishing scenarios inputs and assumptions in its IASR which it updates as part of the ISP development process... AEMO should also follow the single stage process... when developing the inputs and assumptions underpinning a reliability forecast to include in the IASR... Active involvement should not be limited to sharing ISP outputs but should allow AER to see that AEMO has properly considered stakeholder input and followed the process is in this FBPG to engage with stakeholders;

and, at 2.5 dealing with updates affecting the FBPG:

under NER 5.22.15(c) AEMO *must* consult on new information and its impact on the optimal development path in accordance with this section...AEMO is required to follow the single stage process in appendix B.

So far as is relevant that single stage process involves consultation of the kind claimed to be necessary and have been forgone in the present matter going to the claimed waiver.

While the NER permits AER to specify those parts of the guidelines binding on AEMO, this is not on an *ad hoc* basis, but as set forth in the guidelines themselves and in precise detail. No discretion to waive compliance is contemplated in those parts of the FBPG that have been declared to be binding requirements or binding considerations .

No discretion as to that consultative process is contemplated .

In turn, the consultation that is mandated by the FBPG in relation to both IASR and ISP updates imposes a further duty on AEMO and AER by *requiring* the facilitation of active AER involvement including the proper consideration of stakeholder input and engagement with stakeholders.

Finally as has been noted above, the FBPG at section 2.5, applying NER 5.22.15 mandates that AEMO *must* consult on new information and its impact on the ODP as set out in Appendix B.

No such consultation was undertaken. It is not to the point that an earlier different consultation with other stakeholders may have covered the same or similar issues and topics. The law required the consultation mandated by the rule. It was not undertaken and the decision is at best voidable, or perhaps void *ab initio* as a result. No discretion for AER to forgive such a breach can be found in the legislation – no rule is formulated to supersede the duty imposed on AER which was to enforce compliance by AEMO with the FBPG.

Again it is clear that no discretion to waive this precise consultative process required to be undertaken by AEMO is afforded AER by the legislation or the FBPG. The duty of AER is to ensure that the Rules have been complied with both in spirit and in the letter of the law.

It is apparent that this has not occurred in relation to the HumeLink and VNI West projects – as Ms Savage effectively admitted before the Senate Committee. What appears to have been done is that AER has exercised a discretion to waive compliance with the law in favour of the two projects. That discretion does not appear to exist other than in the mind of the regulator. It is not to be found in the legislative instruments.

As Justice Hayne pointed out in the Royal Commission referred to above, compliance with the law is not a matter of choice.

In the event that no right of waiver of the statutory obligation can be demonstrated the question then arises whether a remedy exists and by whom any remedy may be sought.

The failure properly to consult as to the impact of the proposed in my opinion renders the decision vulnerable to challenge by a party with appropriate standing in both the Supreme Courts of the affected States and in the Federal Court, as set out below.

The answer to the question who may act lies outside the scope of this advice but for identifying the possible course that may be taken in relation to decisions made by the AER. This in turn involves considering the terms of the inter-government agreement under which the NEL was established.7 which was entered into between the Commonwealth and all Australian States and Territories and so far as I am instructed was most recently amended on 9 December 2013.

That agreement provides *inter alia* that implementing legislation [NEL] would make provision that the decisions of the AEMC and AER would be subject to review by clause 12.1. That clause provided:

> *the implementing legislation will have effect that on a date or dates to be agreed between the parties;*
> *(a) decisions of the AEMC will be subject to judicial review principally by the Supreme Court of each of the States and Territories without affecting the inherent jurisdiction of those courts to hear judicial review proceedings; and*
> *(b) decisions of the AER will be subject to judicial review by the Federal Court*

So far at least as the AEMO is concerned section 70 of the NEL provides that a person who is aggrieved by a decision made by AEMO under the NER or conduct engaged in by AEMO for the purpose of making such a decision may apply to the [appropriate] Supreme Court for judicial review of the decision or relevant conduct.

It is not clear that this provision extends to conduct of all decisions made by AER especially of the kind here under scrutiny. The legislation nonetheless contains a

note to the effect that the AER is subject to judicial review under the Administrative Decisions (Judicial Review) Act 1977, Commonwealth.

It is important to note that an application does not affect the operation of the decision or determination or prevent the taking of action to implement that decision or determination absent a specific order of the court to that effect.

Standing to bring proceedings for judicial review either under the NEL or under the ADJR legislation is provided to a person aggrieved, which is defined to include *a person whose interests are adversely affected*

Such proceedings are public interest proceedings and bringing any such application for judicial review will likely be strenuously resisted by any of AEMO, AER and or AEMC.