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By email: LMR.Secretariat@ret.gov.au

Review of Limited Merits Review Secretariat
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Dear Expert Panel

Review of Limited Merits Review—Discussion Paper 3

Thank you for the opportunity to respond to the Expert Panel's third discussion paper. We appreciated the opportunity to meet with you on 2 August.

Introduction and approach

We agree and strongly welcome that the Panel has correctly identified the main problems with the current Limited Merits Review Regime (the **LMR**), that is, the unduly narrow and overly formulistic approach taken to reviews and an insufficiency of attention to the National Electricity Objective (**NEO**) and National Gas Objective (**NGO**). We also consider that these matters are likely to have contributed to the number of appeals, which, in a purely numerical sense, we consider reflects significant problems with the LMR.

Incidentally, we are strongly supportive of the Panel's interpretation of the NEO and the NGO, particularly the conclusion that it is a 'requirement that regulatory decisions be directed toward encouraging outcomes that are in the long term interests of consumers'.[i] It is our experience that the NEO and the NGO are often interpreted with a much narrower focus on 'economic efficiency'. It is our view that while pure economic efficiency may contribute to the long term interests of consumers, it does not always do so.

We note also that even where focus is properly on the 'long term interests of consumers' the range of possible economic theories or positions that can be applied to this phrase can lead to significantly different outcomes. To take just one example, a total welfare view of 'long term interests of consumers' would be very different from a consumer welfare view of the same question. We therefore urge the Panel in developing this line of thinking, to consider what additional guidance may be desirable for decision makers and reviewers in applying this objective.

We have one note of caution, however, with the approach being taken by the Panel. As noted on page three of the paper, the Panel is taking an approach that examines individual features or

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characteristics of review processes, with a view to assess whether adjustments would or would not serve to strengthen the effectiveness, judged in terms of the NEO and NGO, of the wider framework for regulation. While we do not have a problem with this approach per se, it appears that the Panel is seeking to examine characteristics of a *merits* review framework, to determine whether it can achieve the desired outcomes. As noted in our previous submissions (and further below), we maintain significant reticence over whether *any* system of merits review short of full (or de novo) merits review can operate to strengthen the effectiveness of the wider framework for electricity and gas regulation in a real sense as distinct from a theoretical one. It is also worth repeating our concerns regarding the potential costs[ii] of a full merits review process and its capacity to replicate the consultative and broad nature of the AER's initial process of price determination.

In support of network pricing determinations being subject to judicial review only, we note the publication of the Administrative Review Council, 'What decisions should be subject to merits review'?[iii] Chapter 4 of that publication lists a number of factors that may justify excluding merits review. One of the factors listed is 'decisions involving extensive inquiry processes'. The Council notes:

> This exception covers decisions that are the product of processes that would be time-consuming and costly on review. Such processes include public inquiries and consultations that require the participation of many people. If review of the subsequent decisions was undertaken, the nature of the review process would be changed from the normal adjudicative decision-making process (of, say, the AAT), to a greatly expanded and time-consuming one.

In our view, network pricing determinations is such a decision that involves extensive inquiry processes. Further, the experience of the existing regime is one that is time-consuming, inhibiting regulatory certainty.

We outline these matters to encourage the Panel to consider not only a framework of merits review, but also whether a system where parties can seek judicial review only might better operate to improve the effectiveness of the regulatory regime. Allied to this point we note our view that *any* regime chosen will involve trade offs as between the policy intents exemplified by the MCE objectives. In balancing these trade offs we urge the Panel to take a practical as well as legal and economic matters into account. In particular we urge consideration of factors relating to human and organisational behaviour and incentives to appeal.

A good example is consideration of the operation of section 71O(1) of the National Electricity Law (**NEL**) and section 258(1) of the National Gas Law (**NGL**). We understand that the Panel remains unclear as to why the Australian Energy Regulator (the **AER**) has not sought to broaden issues considered in appeal hearings, pursuant to these sections. As noted in our previous submission to the Panel, it is our view that the AER is not *legally* constrained from relying on these powers and, hence, we are not sure that the legal advice being sought will shed much light. Being constituted by individuals, the AER is, however, restrained by a range of *human* factors meaning it is unlikely to seek to broaden appeals. These factors may include:

- a desire not to have been seen to have made an initial error, and therefore a desire not to appeal its own decision;

- a desire to minimise the costs of an appeal (whether due to interpretation of the model litigant policy, budgetary constraints, or other factors);
- over-reliance on legal advice which can be conservative particularly as to prospects of success in taking new approaches or untested areas of the law (which we suggest would be involved in seeking to argue a recasting of the focus of appeals on the NEO or NGO);
- lack of litigation experience;
- a desire to be seen to be working constructively with the regulated industry.

While we understand that the matters referred to in the first dot points in particular maybe based upon a mischaracterisation of how the Panel contemplates economic determinations should be undertaken (that is, the Panel believes that determinations are to be undertaken in a holistic manner rather than on the basis of smaller, individual determinations that might be in 'error'), it is nevertheless a reasonable position for a decision-maker of consequence to take.

Possible characteristics of alternative review arrangements

1. Scope of issues/questions the review body can/must consider

We understand the attraction to allowing a much wider scope of issues that can be considered during a review, as it will mean that issues that are possibly negative to the appealing body (always a network business) will be able to be considered. This might mean there is a greater risk for networks to appeal decisions, as they are less able to limit issues to be considered to those upon which they may "win". If the Panel is minded to recommend a form of merits review, we believe that a full *de novo* merits review is likely to result in lesser appeals being sought by networks.

We note that the Panel is interested as to whether the review body is able to assess the regulatory decision as a whole, with merits being assessed on the basis of the statutory objectives in the NEL and NGL. If the Panel is not minded to recommend a full *de novo* review, we support a proposal where the *only* ground for merits review is that the determination, as a whole, does not meet the overarching statutory objectives. This might ensure that the regulatory framework remains focused on the long term interests of consumers, even where the regulator necessarily has to examine detailed proposals from network businesses. Such an approach is also likely to ensure the application of the regulatory regime is purposive, rather than focused on the black letter of the rules.

Finally we would note to the Panel the importance of the location of the onus of proof. We note and support the New Zealand approach in this regard. More particularly we are of the view that if a merits review framework is recommended, then the onus should be placed on the appellant/s (likely to be the regulated business/es) to establish that a pricing determination is not in the long term interests of consumers.

2. Substitution/remittal/recommendation

We do not have strong views about whether a review body should, once it has found a regulatory determination deficient, substitute its own decision, remit to the initial decision-maker for the decision to be re-made, or provide guidance or a recommendation to the regulator. Noting that there is currently limited guidance given to the review body, we are minded to support there

being some guidance for it so that it makes this decision in a way that supports the objectives of the regulatory framework.

3. Resources of review body

We agree that if there is to be a new form of merits review, it needs to take a broad perspective and be able to draw upon a range of perspectives both at the decision making level and in support to decision makers. This may be resource intensive. The Panel is interested as to whether the review body would be able to draw on existing resources; we would caution against using resources of the Australian Energy Market Commission (**AEMC**), as there may be a conflict between this role and its role as the rule-maker. If sharing of resources is necessary, we would encourage consideration of drawing upon the resources of the Australian Competition and Consumer Commission, which is likely to have expertise but not to be too 'close' to the subject matter at hand.

Consideration of the necessary resources raises the question as to whether an external review process can effectively substitute the initial determinative processes, which involves many stakeholders and can take up to two years.

Whilst by no means asserting that it is without flaws, in this context we make the general point that the legal system has also had to grapple with many of the issues being considered by the Panel and has over hundreds of years developed responses to them. Some areas to note include:

- Recognition that a documentary review, however comprehensive, does not provide the same insights as hearing directly from witnesses—as a consequence, the law only allows appeals on findings of law, not findings of fact. We note the capacity under the present LMR system for the calling of witnesses but assert this is not the same as the more comprehensive and inclusive process engaged in by the AER.
- The desirability of a broad perspective in undertaking reviews—therefore a decision by a single trial judge will generally be considered by a number of appeal judges.
- The development of guidance regarding when a matter will be remitted to the original decision maker and when a decision will be substituted.

4. Time constraints in relation to reviews

We would support relaxation of time constraints, particularly where they operate to limit participation in review processes. Our experience has been that the extremely short period of time to provide notice of intention to intervene and develop a case to present, limits participation by consumer and user groups. While we agree that review processes should not be inordinately lengthy, it is more important that processes are robust and facilitate participation.

5. Location of review function: internal and external

We are not convinced that an internal review process will operate to reduce the number of appeals or the length and cost of review processes. If the prospect remains that a network business can appeal with limited downside, then that opportunity will be taken.

We note that Panel's view that organisational separation can contribute to 'seeing things from a slightly different perspective'. This may be true, but we note that a different perspective is not

necessarily more correct or preferable—economic determinations, as noted in our initial submissions, are not conducive to one 'correct' or 'right' answer.

6. The nature and processes of the review body

It appears that the Panel, in this section of the paper, is making a distinction between review processes that are more inquisitorial versus processes that might be adversarial. In our view, merits review processes should, by their very nature, be more inquisitorial—an effective decision-maker should not be limited by the matters put forward by parties; they should consider other matters (including the initial decision and other related material).

We would also agree that there might be more consumer and user engagement in review processes where they are administrative in nature, and less court-like. However, we are concerned by what the Panel describes as the propensity for administrative agencies to compete with each other for power and influence adding to instability and uncertainty. We note that this might be driven by diversity in economic views and the absence of a 'correct' answer. This again might point to a system where judicial review is the only forum for appeal being more appropriate.

7. Composition of review panel

We would agree that the existing pool of review panel members is small. As noted above, we also consider it desirable that the Panel has access to a broad range of perspectives through secretariat and support arrangements. However, practically speaking, we are concerned as to the availability of experts to undertake this function—most experts work with or are regularly engaged by the regulatory and industry. This was a specific problem that faced us when seeking to intervene; there was a view that we needed a 'world leading expert' to wield our evidence. Access to such expertise is not easy to come by.

8. Consumer/user engagement

We agree with the Panel's assessment that the notion of a consumer advocate acting as a contradictor in the appeals process presupposes that the process will continue to be adversarial. Noting our comments above, rather than 'raising the question of whether or not a new interface is in order', we question whether there should be this interface (i.e. a merits review process) at all.

9. Margins of discretion

While we agree that review systems do (and should) grant some margin of discretion to primary decision makers, we do not think the materiality thresholds in the LMR have operated to provide an effective margin of discretion to the AER. In fact, in our assessment, there does not appear to have been any (or, at least, many) applications by network business for review by the ACT that have been denied.

It is our view that a system of judicial review only would provide the AER with an appropriate margin of discretion. This might be achieved by clearly defining that the bases on which judicial review can be sought are the traditional bases listed in the *Administrative Decisions (Judicial Review) Act 1977* relating to the process by which the decision is made and, perhaps, an additional ground being where the decision does not further or accord with the consumer interests as per the statutory objective.

We note that the AEMC's Draft Determination on the Economic Regulation of Network Service Providers (released on 23 August) proposes to grant greater discretion to the AER, particularly with respect to the rate of return, but also with respect to the AER's ability to consider and substitute expenditure forecasts put forward by network businesses. Importantly, the rules will be amended to clarify that when the AER replaces a network business's forecast with a substitute value or amount, it will not be required that the substitute is determined on the basis of the business's proposal and amended from that basis only to the extent necessary.

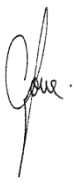
This change will provide the AER with a further margin for discretion. It is our view that this is appropriate, but that it may perversely operate to enhance the likelihood that the AER's decision will be reviewed as the discretion may be interpreted differently by the review body. As noted above, merits review in the context of economic regulation is likely to invite a range of different but not necessarily 'correct' economic views. Without fundamental change, merits review is likely to contribute to reduced regulatory certainty where it appears that the AEMC is attempting to balance certainty with the long term interests of consumers.

10. The incentives to reach agreement/settle

While there may be some attraction (e.g. from a costs perspective) for review processes to encourage agreement or settlement, we are concerned about the effectiveness of such an approach where users or consumers are effectively excluded from the review. The Panel notes that, in the UK context where settlement is more common, that the only parties are the regulated and the regulatees. If the settlement is between these parties, then it is likely to only operate to depart from the initial regulator's decision in favour of the network businesses—it's hard to see why a network business would accept a settlement on the terms initially proposed by the regulator. Settlements that favour network businesses will not be in the interests of consumers, and therefore we would not support a framework that incentivised such an outcome. In our view, any focus for regulatory settlements should be focusing on how settlements can be achieved between consumers and regulated businesses.

Please contact us on 03 9670 5088 if you would like to discuss these matters further.

Yours sincerely
CONSUMER ACTION LAW CENTRE



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[i] Review of Limited Merits Review, Stage One Report, page 3.
[ii] We note that if numbers of appeals under a full merits review models were materially less than under the current regime, then the theoretical cost of full merits review may in fact be less than the actual cost of the current very high numbers of appeals under the limited merits review regime.
[iii] Administrative Review Council, *What decisions should be subject to administrative review?,* 1999.