Should the Law Have a Greater Role in Economic Regulation of Infrastructure Services?

To answer this question requires an overview of the role which the law currently plays in respect of economic regulators like IPART, to create a baseline for comparison.

Throughout my paper I have used IPART as the lead example because it is the economic regulator with which I am most familiar, but I think the points hold true for other Australian economic regulators as well, especially State-based regulators as they are not as constrained by constitutional issues as some Commonwealth regulators.

In relation to economic regulators, the role of the law can be broken down into 3 broad components:

1. The establishment and grant of powers to economic regulators;
2. Governing the core decision-making of economic regulators; and
3. Governing or influencing the processes leading up to and following after decisions of economic regulators.
1. The establishment and grant of powers to economic regulators

Here the law and, more specifically, statutory law is essential. Economic and competition regulators of the kind now considered mainstream are creatures of the second half of the twentieth century. They come with the slow but far-reaching acceptance in Western democracies of the pro-competition principles which had their origins in the United States in the late 19th century with the passing of the first anti-trust laws. In Australia it took until 1974 for the Trade Practices Act to be passed, with the States lagging some way behind before passing Fair Trading Acts which mainly mirror only the consumer protection provisions of the TPA.

But the real growth of economic regulation and economic regulators came in the 1990s with the acceptance of Competition Principles, and the segregation and corporatisation of government businesses, especially infrastructure businesses and their transition to a competitively neutral environment. The economic regulators were both a product of and instrumental in promoting concepts such as “user pays” and the relevance of pricing signals both to investors in and consumers of infrastructure services.
The divestiture and privatisation of a number of formerly government-owned businesses created a need to regulate those businesses or at least their monopoly infrastructure once they could no longer be controlled through ownership rights. Telstra is a case in point. In other cases monopoly infrastructure businesses are still owned by government, and the purpose of economic regulation is to simulate a competitive market to drive operational and investment efficiencies.

Everything in this new pro-competition world was built on statute, including the creation of regulators such as the ACCC, the QCA and IPART. The pattern of legislation creating economic regulators has been to give them broad powers to deal with the subject-matters assigned to them under the umbrella of broadly stated pro-competition objectives. IPART is a bit of an exception to this pattern, largely I suspect because it was one of the earliest to be established and pre-dates the adoption by governments of the Competition Principles Agreement in 1995. The IPART Act does not include any over-arching statement of lofty principle.

Legislation establishing the economic regulators has been largely stable. The legislation establishing IPART has been amended only a small number of times in almost 20 years and on most occasions this has been to add
subject-matters to IPART’s jurisdiction, and not to change its fundamental
structure or powers.

So on the first limb, the establishment and grant of powers to economic
regulators, the law is essential, particularly statutory law, but its
contribution is largely already made.

2. Governing the core decision-making of economic regulators

The second limb is the delineation and control of the key substantive
decision-making parameters under which economic regulators operate.

Here, in my view, greater intervention of the law is not desirable. What
economic regulators do is to weigh up and balance the conflicting policy
objectives in their charters and the competing interests of their
stakeholders in an ever-changing economic and political environment. In
some instances, such as water regulation, even the ever-changing climatic
environment is relevant.

This is not territory in which the law and traditional legal processes are
particularly helpful. In a traditional legal contest there are clearly identified
parties with more or less defined rights and claims which delineate and
confine the scope for decision-making. Decisions are made largely based on
the material and arguments which the parties put forward. For each
argument there is a proponent and an opponent. The role of the decision-maker is umpire rather than originator. The interests of third parties who are not directly involved count for little or nothing.

That is not the world of economic regulation. In the pricing work which we do at IPART, the agency affected does not always even put forward a proposal. The core regulatory approach is more often than not originated by us and the interests of all affected stakeholders are relevant, whether they are represented or not. All important decisions are published in draft for comment, and all submissions are taken into account.

While it is not the function of IPART to make consensus decisions, its processes do have the effect of narrowing down the topics on which stakeholder opinions differ. Sometimes we even persuade them to change their minds and sometimes they persuade us. At the end of the day, however, our job is to balance the competing interests and the frequently conflicting parameters set out in our terms of reference, and to find a middle way.

Many of the decisions we make are affected by section 15 of the IPART Act. If one looks at the conflicting policy objectives listed in section 15 they include the following:
Matters to be considered by Tribunal under this Act

(1) In making determinations and recommendations under this Act, the Tribunal is to have regard to the following matters (in addition to any other matters the Tribunal considers relevant):

(a) the cost of providing the services concerned,

(b) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of services,

(c) the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales,

(d) the effect on general price inflation over the medium term,

(e) the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers,

(f) the need to maintain ecologically sustainable development (within the meaning of section 6 of the Protection of the Environment Administration Act 1991) by appropriate pricing policies that take account of all the feasible options available to protect the environment,
(g) the impact on pricing policies of borrowing, capital and dividend requirements of the government agency concerned and, in particular, the impact of any need to renew or increase relevant assets,

(h) the impact on pricing policies of any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body,

(i) the need to promote competition in the supply of the services concerned,

(j) considerations of demand management (including levels of demand) and least cost planning,

(k) the social impact of the determinations and recommendations,

(l) standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise).

In addition to the tension between many of the section 15 matters, it is important to note the residual discretion given to IPART, to have regard to “any other matters” the Tribunal considers relevant.

And so we balance the need for cost reflective pricing against the protection of consumers from excessive price shocks, and we balance the need of State
utilities to be rated BBB+ against the need for consumers to adjust to price increases which are individually manageable but cumulatively difficult, and we balance the need for State utilities to invest capital expenditure in big lumps against the needs of consumers to have prices glide upwards rather than step upwards, and we balance the interests of those who benefit from capital projects now against those who will benefit from them in the future.

It is hard to see what the law could do to facilitate the ability of IPART to weigh up all these matters, when ultimately a significant and unavoidable judgment call is required. The law is uncomfortable with discretion and especially with open-ended discretion. Its approach is usually to seek to define the outer limits of the discretion, to prescribe as closely as possible what must be taken into account and preferably how much weight is to be given to what. In my view, neither IPART nor its stakeholders would be assisted by that. It is hard to see how the greater intervention of the law would facilitate the core decision-making task of an economic regulator such as IPART.

For these reasons it does not seem to me that the law has a great deal more to contribute to the core decision-making function of an economic regulator like IPART.
3. Governing or influencing the processes leading up to and following after decisions of economic regulators

Having considered the provisions which establish economic regulators and give them their powers, and having dealt with the circumstances in which economic regulators exercise their core decision-making functions, the third limb is to have a look at the processes leading up to economic regulatory decisions, and the processes which follow them, to consider whether the law could usefully have a greater input.

Process is the area where the law has perhaps the greatest contribution to make in economic regulation. Many of the things which economic regulators now do more or less intuitively derive from the law or more specifically from administrative law – the body of law developed to enable the courts to supervise and control executive power in administrative decision-making, without exercising that executive power themselves.

The administrative law notion of procedural fairness or natural justice has deeply affected the way in which modern economic regulators go about their decision-making, and is strongly influential in achieving the wide-spread acceptance which their decisions enjoy.
A key concept in administrative law is that executive power in making administrative decisions must be exercised according to law, no matter how wide the discretion of the decision-maker may appear to be.

“According to law” involves a number of requirements. The power must be exercised bona fide for the purpose for which it was given, and not for an ulterior purpose. The decision-maker must be impartial in terms of having no stake in the outcome and in terms of having an open mind and not being biased. The decision-maker must take relevant material into account but must exclude irrelevant material. The decision-maker must actually make the decision and not be beholden to someone else who has not been given the decision-making power. And so on.

In addition to all of these requirements which derive from the common law of administrative law, there are requirements of administrative law statutes such as the Commonwealth Administrative Decisions Judicial Review Act which have been adopted and internalised by economic regulators whether or not the ADJR Act (or a State equivalent where these exist) actually applies to them. These additional statutory-based requirements include the need for a regulatory decision to be accompanied by a statement of reasons, and the requirement that a regulator must be able to identify what material it has relied upon and what it has taken into account.
It may come as a surprise that, in 1980 when the ADJR Act came into effect, these requirements were by no means mainstream. It is now unimaginable to think of an IPART report, at least, without them.

Failure to observe the requirements of procedural fairness or natural justice as it used to be called, gave the courts a basis to intervene in administrative decision-making. The intervention was never undertaken to substitute their own decision for that of the original decision-maker, never to express an open view on what would or should have been the correct or preferable decision. The role of the courts was to analyse and correct the process and send the matter back to the original decision-maker to try again. This unwillingness to re-make the actual decision reflected two things –

First, the fundamental unwillingness of the legal system to make policy-based decisions for which it does not have the experience, training or subject-matter expertise. Second, it reflected concepts of the separation of powers. The role of the judiciary is to supervise the legislature and decide whether laws made are within power. It is also to supervise executive decision-making and ensure it is done according to law. In the case of administrative decisions which are an example of the exercise of executive power, you cannot maintain the supervisory role of the judiciary and the separation of powers if the judiciary
steps in and assumes the role of the person or entity whose decision-making it is supervising.

In the application of these concepts, administrative law has had a very real and tangible role to play in the balance of powers among the legislature, the judiciary and the executive (which includes economic regulators).

Which brings us to merits review. Merits review is the review of decisions where the reviewing body can substitute its views on what is the right or preferable decision for that of the original decision-maker. Merits review is the diametric opposite of judicial review which I described earlier. Merits review is a relatively new innovation and it is entirely a creature of statute.

Merits review is almost always carried out by administrative tribunals such as the Commonwealth Administrative Appeals Tribunal which have among their members a mixture of lawyers and subject-matter experts.

Turning to the processes which IPART adopts in its investigations and determinations, they are partly regulated, but are largely self-imposed. Among its 5 core objectives, IPART includes as number one the achievement of fair and transparent processes. This is achieved in a range of ways, all of which can be tied back to administrative law concepts which have been internalised in the decision-making processes of the Tribunal. The Tribunal publishes the timeline for its processes to maximise the notice given to stakeholders of the
opportunities they will have for input, and to minimise delays. In areas involving methodologies of technical complexity, the Tribunal frequently publishes papers outlining the proposed methodologies and conducts public workshops to discuss and test them. All reports are published first in draft and stakeholders have an opportunity to make written submissions and frequently also to attend and speak at public hearings.

According to stakeholder surveys, the Tribunal has succeeded in running processes which are consultative, transparent, inclusive and respectful. Its decisions enjoy widespread acceptance, even from those who don’t like the outcome.

It is difficult to see what the difference would be for practical purposes if IPART’s processes were legally mandated in fine detail rather than voluntarily adopted and tailored to the needs of individual investigations.

IPART is, of course, fortunate in that most of the entities regulated by it come to it seeking price increases to fund capital expenditure or service improvements or both. They have no economic incentive to delay or fail to co-operate with information requests. If they do so it tends to be by reason of a lack of management control rather than with the intention of gaming the regulator. The ACCC, for example, faces a rather different task when it is trying to drive change by pushing allowed input costs down against the commercial
interests of an existing incumbent. Under Part XIC of the Trade Practices Act – the telecommunications access regime provisions – examples of gaming the regulator are legion.

The success of an economic regulator’s processes can be measured in part by the number of legal challenges to which it has been subject. While the common law of administrative law applies to IPART, IPART has never been the subject of an application for judicial review. It is not currently subject to merits review and to my knowledge there has been no push to create a layer of merits review.

Merits review tends to have 3 common characteristics –

- Each party pays its own costs irrespective of outcome
- If a new decision is made it is prospective only and not retrospective
- There is no compensation for the time value of money during the review process

In IPART’s situation, the introduction of merits review could have the effect of causing regulated utilities permanent revenue loss through the delay of price increases during the review process. Merits review could play out strategically in areas such as bulk water where a relatively small and identified group of stakeholders have a material commercial interest at stake. If there is no costs
risk other than one’s own costs and no interest risk in requesting merits review, it is a relatively simple calculation to work out whether the NPV of price increases delayed by the process is greater than the NPV of legal costs to be spent in merits review.

In summary, the processes of economic regulators such as IPART leading up to the making of decisions are well developed and well understood by stakeholders. The processes derive from and mimic many of the requirements of procedural fairness in administrative law. In large part the law has already had a profound effect by the creation of new norms, even where particular legal provisions are not directly applicable to the regulator in question. It is difficult to see what benefit would flow from the law taking an expanded role in this area.

In terms of review, judicial review applies to IPART but has not to date been accessed by anyone. Merits review does not apply and there is no push to introduce it. So, all in all, in this third limb of processes before and after decision-making, IPART is well served and there is no obvious expanded role for the law.
Conclusions

In closing then, having broken down the role of economic regulators into 3 main areas:

- The legal provisions which establish them and give them powers
- The provisions which delineate and control their core decision-making
- Their processes before decision-making, and review of decisions after the event,

I’ve concluded that the law is essential to the first, largely unable to add value to the second and highly relevant to the third but has largely achieved its objectives without further input being required.

And so the answer to my topic question: “Should the law have a greater role in economic regulation of infrastructure services?” is no.

Or as we lawyers prefer to say, “In all the circumstances, based on the facts as we understand them, on balance, probably not.”

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