Sir

The purpose of this letter is to provide some further brief comments on the submission made to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee (the "Committee") by the Australian Competition and Consumer Commission (the "Commission") in respect of the Committee's inquiry into the Trade Practices Amendment (Telecommunications) Bill 2001 (the "Bill") and dated 6 September 2001 (the "Submission").

In particular, it is, in my view, important to draw the Committee's attention to the loose usage by the Commission of the terms "arbitration" and "arbitrate" in its discussion of the so-called "negotiate-arbitrate" model. The Commission suggests that these terms are to be given the same meaning as "commercial arbitration" as is provided for in commercial contracts. Having thus assimilated the terms, the Commission argues that because commercial arbitration is typically final, so should be the arbitrations it conducts under the provisions of Part XIC of the Trade Practices Act 1974 (Cth) (the "Act").

I would submit that the Commission's assertions are fundamentally incorrect.

More specifically, it is the essence of commercial arbitration that it determines a dispute between individuals without vesting in that dispute broader, public policy, significance. Two factors are crucial in this respect.

The first is that commercial arbitration is an inherently voluntary process. The parties provide for it under contract; by definition, an enforceable contract cannot be one into which the parties have been coerced. Hence, the dispute and its means of resolution have been determined by the parties independently of the exercise of any coercive powers of the Commonwealth.

The second crucial element is that the determination of disputes under commercial arbitration is not intended to, and by its design cannot, have precedential value. Rather, it is private to the parties in exactly the same way as the contract between them is a form of private and voluntary ordering. Indeed, the lack of a requirement to give reasons, and of any implied obligation on the arbiter to act in a manner consistent with previous decisions, ensures that no such precedential role can be played by commercial arbitration.

It has been widely accepted, for many years, in the scholarly literature that it is the resulting essentially private nature of the dispute resolution process that distinguishes commercial arbitration from adjudication as a means of settling disputes. I would be happy to provide your Committee with extensive references in this respect.

In contrast, it is apparent the Commission's exercise of its powers under the Act is inherently a form of use of the Commonwealth's coercive powers to public policy ends. Thus, the Commission is given coercive means to ensure that the parties submit to its process of dispute resolution; moreover, it is clear that there is the intention that decisions in any one dispute should guide those in others. The process is consequently one of administrative decision-making, rather than the result of voluntary ordering by the parties. By reason of the scope for use of coercive powers, and of the impact any

one decision has on those to be taken subsequently, such decision-making requires a high degree of scrutiny, all the more so when its economic consequences are so great.

The mere fact that the terms “arbitrate” and “arbitration” may be used in describing this form of decision-making cannot and should not hide the differences of substance between what is at issue here and voluntary commercial and contractual processes. The extent of these differences, and their great implications for public policy, have been well set out by the National Competition Council in its 1st Submission to the current inquiry by the Productivity Commission into Part IIIA of the Act – see pages 31 and follows of that Submission. It is a pity that the ACCC has so obfuscated matters that it surely well understands.

Yours sincerely

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13th September 2001

Trade Practices Amendment (Telecommunications) Bill 2001

Submission to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee

September 2001

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1 Overview

The purpose of this submission is to provide some brief comments on the submission made to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee (the "Committee") by the Australian Competition and Consumer Commission (the "Commission") in respect of the Committee's inquiry into the Trade Practices Amendment (Telecommunications) Bill 2001 (the "Bill") and dated 6 September 2001 (the "Submission").

While NECG has a number of concerns with the Submission, the focus of these comments is on the question of merits review rights.

In its submission, the Commission makes a number of claims to the effect that merits review of arbitration determinations under Part XIC of the Trade Practices Act 1974 (Cth) (the "Act") is neither necessary nor desirable. Furthermore, the Commission claims that such review "can create perverse incentives for the efficient and effective operation of the access regime"[1] and increase uncertainty and regulatory costs. The Commission also makes the misleading statement that an analysis of merits review in other jurisdictions shows that "it is unusual for there to be provisions providing for a full re-hearing on the merits by an appeals body of an access pricing decision".[2]

Claims by the Commission (and others) that the so-called "negotiate-arbitrate-re-arbitrate" model[3] adds an unnecessary layer of decision-making to an already slow process, with no

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1 Submission, page 7.

2 Submission, page 9.

3 NECG notes that, even this shorthand characterisation of the merits review process is misleading. Whilst merits review in this context is described under s152DO(3) of the Act as a "re-arbitration", the reality is that, by the time the merits review stage is reached, the issues in contention have been significantly distilled and narrowed. In addition, most of the evidence will already have been adduced. An appreciation of this also shows that suggestions that merits review somehow adds an equivalent, or even greater, length of time

offsetting benefits are simply without foundation. Similarly, claims that such a process also adds significantly to delays are simply untrue[4] and serve as a red herring to distract the Committee from the critical role of merits review processes in the present context.

The purpose of this submission is to bring to the Committee's attention that:

- there are very high risks of error occurring in regulatory decision-making and the costs of such regulatory error are significant;
- in order for efficient investment decisions to be made, there needs to be an understanding in the market (including within capital markets) of the approach that will be adopted by a regulator - that understanding evolves through the development, not merely of a quantity of administrative decisions, but through the development of a body of precedent testing that decision-making;
- only with such a body of precedent, can an investor be confident that it will not be subject to arbitrary or ill-founded decision-making; and
- review through the operation of the Administrative Decisions (Judicial Review) Act 1977 (Cth) (the "AD(JR) Act") and appeals to the Federal Court on questions of law does not provide a sufficient foundation from which to form the necessary level of confidence.

Merits review constitutes an absolutely fundamental weapon against regulatory error, and the costs of such error. As such, it is a critical element in providing certainty for investment decisions that are fundamental to Australia's economic interests.

Furthermore, as these comments will show, merits review of arbitration determinations under Part XIC of the Act is entirely consistent with:

- the experience in the United States where the evolution of utility regulation through judicial review of the substance of decision-making has been a major contributor to

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to that already expended by the Commission in the initial arbitration, overstates the true position.

4 Refer the comments in footnote 3. See, also, the text accompanying footnote 32.

private investor confidence in that sector; and

- the frameworks being adopted in other jurisdictions, such as the European Union.

These considerations are discussed in further detail below. NECG would be happy to elaborate on any of the material presented in this document.

2 Costs of regulatory error

2.1 Generally

Regulatory policy is concerned with correcting market failures attributable to market power. Regulators can err in at least two respects:[5] first, in deciding whether regulatory intervention is or is not necessary; and secondly, if intervention is considered to be warranted, in determining the form and substance of that intervention.

Regulatory errors lead to error costs in the form of a range of efficiency losses. The costs of regulatory error are widely recognised. For example, the National Competition Council has stated that:[6]

> "... Access regulation can also entail costs if it is applied inappropriately or too widely. First, it may diminish incentives for businesses to invest in infrastructure facilities and thus limit, rather than enhance, overall competition and economic efficiency. Second, compelling infrastructure owners to provide access to others necessarily can impinge on their private property rights. Third, legislated access regimes are but one of several regulatory mechanisms available for countering market power. The choice of regulatory tool needs to be aligned properly with the source of the mark of power problems. If access regulation is used when better tools are available, further market distortions may arise ... Overall, the Council

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5 The risks of these errors occurring are especially great in new and / or converging markets.

6 National Competition Council, *National Access Regime - A Draft Guide to Part IIIA of the Trade Practices Act*, at page 20.

observes that trade-offs arise in applying access regimes. Applying access regulation proffers benefits through greater competition. However, these benefits need to be weighed against the cost ... ”

More recently, the Productivity Commission has summarised the costs of access regimes as follows:[7]

> “Access regulation can involve a significant abrogation of private property rights. Such abrogation can give rise to a range of costs, particularly if access regulation is poorly specified meaning that the implications for property rights are ill-defined. Uncertainty about the property right implications of changes to access regulation can also give rise to similar costs. The costs emanating from the alteration of property rights under access regulation can take a number of forms, including:
>
> - Administrative costs for government and compliance costs for business;
> - Constraints on the scope for infrastructure providers to deliver and price their services efficiently;
> - Reduced incentives to invest in infrastructure facilities;
> - Inefficient investment in related markets; and
> - Wasteful strategic behaviour by both service providers and access seekers.”

The Productivity Commission has similarly recognised the significant costs of regulatory error in its current review of Part XIC of the Act, commenting that:[8]

> “Regulatory interventions are not costless — a point made by several participants (for example, IPA sub. 20, p. 3). Apart from their obvious compliance costs, they can also produce their own set of inefficiencies because they involve the use of imperfect instruments devised under circumstances of asymmetric information and uncertainty by regulators. They impose rules on markets that can ‘have

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7 Productivity Commission, *Review of the National Access Regime*, Position Paper, Canberra, March 2001 (the “Position Paper”), at page 53.

8 Productivity Commission, *Telecommunications Competition Regulation*, Draft Report, Canberra, March 2001, pages 2.42-2.46.

chilling effects on entrepreneurship and innovation' (Yarrow 2000, p. 3).

…

There are two advantages of conceding that a telecommunications competition regulator is unlikely to be perfect. First, this motivates institutional ways of reducing its incentive problems (such as providing statutory independence or shifting responsibilities from an industry specific regulator to a more general one — as in the case of the ACCC). Second, it makes clear that just as markets may fail if some firms exercise apparent market power, the institutions and regulations intended to overcome these deviations from the competitive ideal may also fail. If the shortcomings of regulatory processes cannot be successfully overcome, it may sometimes be efficient to forgo some aspects of competition regulation."

Finally, the Commission itself recognises the risks and costs of regulatory error. The current Chairman of the Commission has recently stated that:

"Sector-specific regulation risks regulatory 'capture' and, by definition, creates a need to define jurisdictional boundaries. That in turn can create problems relating to regulatory uncertainty and inconsistency of application of laws; competitive distortions and misallocation of resources caused by competing firms being subjected to different regulatory regimes; and competitive distortions arising from regulators trying to preserve their jurisdiction over firms by restricting the businesses that regulated entities can engage in.

The seriousness of these regulatory risks is significantly increased if sector-specific regulators also acquire competition law enforcement functions and proceed to elaborate different competition laws for different sectors."[9]

[9] Professor Allan Fels, "Lessons from International Experience", Paper presented at conference organised by ECES and the Australian Embassy held in Cairo and entitled *Competition Policy: The Road Ahead for Egypt*, 24 May 2001.

2.2 Telecommunications context

The nature of the current telecommunications-specific regulatory regime creates substantial potential for regulatory error and increased costs of such error.

First and foremost, there is a substantially increased potential for regulatory error arising from the lack of concrete guidance that the current regime provides to the regulator in terms of the implementation of the regime's general provisions.

For example, under the current provisions of Part XIC of the Act, the Commission has significant discretion in its application of the Total Service Long Run Incremental Cost ("TSLRIC") methodology to determine access prices. This has resulted in a wide, generally completely unexplained, divergence in its estimates of TSLRIC over time. The scope to thus vary estimates, with little by way of credible explanation, creates significant potential for error.

By contrast, regulators operating under Part IIIA of the Act are constrained to at least some extent by provisions in the relevant industry codes (for example, under the *National Third Party Access Code for Natural Gas Pipelines* and under the *National Electricity Code*). In addition, other regulatory regimes operating on state-based certified agreements have in-built safeguards (for example, the regulatory regimes for the Victorian and South Australian electricity distribution businesses).

While the effectiveness of these safeguards is open to considerable debate, the fact is that regulators operating under these regimes are subject to more stringent constraints than is the Commission in its exercise of its powers under Part XIC of the Act.

Secondly, the costs of such errors (for example, setting access prices too low) can be especially severe in telecommunications:

- technology is more dynamic and uncertain – as a result, a carrier would potentially face, not only an inability to obtain the required return on its assets, but also the cost of physically replacing the asset within a relatively short period; and
- there is a greater immediate need for investment in the telecommunications sector given the forces of convergence operating. As a result, the errors from incorrect setting of access prices impinge on consumer welfare, not only by distorting the supply of existing services, but also by compromising the development and widespread availability of new services.

This substantial potential for regulatory error and the very substantial potential downsides of such error are particularly acutely felt in terms of their impact on investment incentives.

3 Impact of error risks on investment incentives

The Productivity Commission has accorded high priority to the potential for inappropriate access regulation to have a significant detrimental impact on the incentives for efficient investment. Reflecting this, the Productivity Commission has highlighted that:

> "… given the asymmetry in the costs of under- and over-compensation of facility owners, together with the informational uncertainties facing regulators, there is a strong in principle case to 'err' on the side of investors. The challenge is how to render this principle operational without creating new problems."[10]

In NECG's view, the Productivity Commission is correct in according priority to the potential for inappropriate access regulation to have a significant detrimental impact on the incentives for efficient investment. In all regulatory systems, regulators have some non-trivial decisions to make, so that outcomes from the future stream of regulatory decision-making processes cannot be predicted with certainty. However, economic theory and anecdotal evidence suggest that there is a very close relationship between firms' exposure to "regulatory risk" and their incentives to invest in infrastructure.[11]

It is impossible to demonstrate conclusively the impact of regulatory risk on investment levels in Australian infrastructure. Nevertheless, there is extensive evidence of investor concerns about regulatory uncertainty and that these concerns are impacting upon the flow of funds into regulated infrastructure. The Joint Industry Submission cites a number of examples of major investors in Australian infrastructure that have expressed significant

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[10] Position Paper, page 71.

[11] A more formal and detailed exposition of the problem of regulatory risk may be found in *Regulatory Risk*, Draft version of a paper prepared for the ACCC Regulation and Investment Conference, Manly, 26-27 March 2001, by Henry Ergas, Jeremy Hornby, Iain Little and John Small, available at http://www.necg.com.au/pappub/papers-ergas-regrisk-mar01.pdf.

concerns with the risks that arise from access regulation and have passed up on significant infrastructure investment opportunities. That submission also provides a number of examples of such concerns being echoed in the press more generally.

Many Australian investors' experiences with regulatory decisions have left them complaining that such decisions have rendered their investments "stranded" and meant that they have been unable to recover their costs. A recent example of such a case, discussed in the Joint Industry Submission to the Productivity Commission's *Review of the National Access Regime*,[12] is the experience of Freight Australia.[13] Various submissions to the Victorian Essential Services Commission inquiry identified numerous other examples of regulatory

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12 Joint Industry Submission to the Productivity Commission's Review of the National Access Regime, 5 June 2001.

13 To recap that case: Freight Australia was purchased from the Victorian Government in May 1999, with access agreements with passenger operators in place, and the possibility of an access regime for freight services foreshadowed at the time of sale. On February 2001, the Minister for Transport announced that, effective 1 July 2001, open access would be declared over Victoria's freight network infrastructure. However, the proposed access regime is inconsistent with that foreshadowed at the time of sale.

Furthermore, the pricing principles set down under the proposed regime do not allow for recovery of the initial investment in the infrastructure in the form of a pre-payment of the lease rental (which amounts to approximately $90 million). The justification for this disallowance is that no return on capital is required for much of the rail network, because it was constructed 'decades ago', and is therefore a sunk cost.

Another problem with the pricing principles under the proposed regime is that they are extremely vague. For example, the pricing principles allow for a margin on operating and maintenance costs set at 10 per cent or 'some other figure that the Office [the ORG] may allow'.

As a result of these uncertainties and changes in the environment in which it does business, NECG understands that Freight Australia, under direction from the RailAmerica board, suspended discretionary capital expenditure in response to what it saw as a threat to its sustained viability.

decisions that left investors unable to recover their costs of investment, to the detriment of their capacity to continue their businesses.[14, 15]

A further example of the problem of regulatory uncertainty adversely affecting efficient investment in infrastructure was Perth Airport's experience with regulation by the Commission. Perth Airport applied to have its investment in a covering for a second runway approved by the Commission under the 'necessary new investment' (NNI) rules set out in the Prices Surveillance Act 1983 (Cth). The Commission decided that the covering was not 'new investment', and was not therefore covered under the NNI rules. NECG understands that the consequence was that Perth Airport could not recover the cost of its investment through increased charges, and the investment will now no longer go ahead.

Finally, the impact of regulatory uncertainty has seen representatives of Telstra make public statements to the effect that it would not be prepared to make substantial investments in respect of its HFC cable network in the presence of such uncertainties.[16]

To some extent, the exposure of investors in regulated industries to a degree of regulatory risk is inevitable. The regulatory policy challenge is to reduce the risks of regulatory error –

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14 See Australian Council for Infrastructure Development, Submission to the Victorian Department of Treasury and Finance, *Essential Services Commission*, September 2000, at Chapter 3 ('Regulatory Risk'), available at: http://www.vic.gov.au/treasury/esc/sn27.pdf

15 The Melbourne Port Corporation (MPC) cited an example of a regulatory decision by the Victorian ORG not to allow MPC to recover its investment in an expansion of railway infrastructure through port charges, even though this has been the historical method of recovering such costs. MPC stated that 'the consequence of the ORG disallowing this expenditure are that the MPC will not be able to generate revenue to enable the funding of an appropriate financial return on this proposed expenditure.' See: Melbourne Port Corporation, Submission to the Victorian Department of Treasury and Finance, *Essential Services Commission*, September 2000, at pages 10-12, available at: http://www.vic.gov.au/treasury/esc/sn47.pdf

16 See, also: (1) http://www.pc.gov.au/inquiry/telecommunications/trans/sydney000814.pdf (at page 16); and (2) re investment in the CAN in respect of universal service obligations: http://www.pc.gov.au/inquiry/telecommunications/trans/sydney000814.pdf (see page 6).

and the associated costs of such errors – so as to increase investor confidence and maintain (and even strengthen) investment incentives.

4 Increasing investor confidence

> "Unless the rule of *stare decisis* is adhered to in the administration of justice under a government of laws, all property must be rendered insecure."[17]

In order to be confident about the regulatory and commercial environment in which it is proposed to make an investment – particularly, a large scale investment that once made will be sunk – investors need to have a clear understanding of the approach that will be adopted by the relevant regulators in exercising their discretion. Investors need to be confident that the exercise of a regulator's discretion will not be arbitrary or biased.

Such confidence is nurtured through the development of the system of precedent. In general legal terms, the fundamental idea behind the role of precedent is that courts must consider how a similar case was decided in the past, even where there are varying ideas about the binding nature of that precedent. A long-standing tradition has viewed precedent as a necessary starting point for judicial decision. When a court departs from this fundamental idea, it violates the essential function of the judiciary to treat like cases alike or explain the difference.[18] It is the non-violation of that essential function through the use of precedent that gives rise to certainty about the non-arbitrary nature of decisions reached.

In NECG's view, a key element in the formulation of a body of precedent that serves the function of increasing certainty – and, in turn, investor confidence – is the provision of merits review rights.

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17 *Jones v Anderson* (1808) 48 (US).

18 Price, P J, "Precedent and Judicial Power after the Founding" (available at: http://www.bc.edu/bc_org/avp/law/lwsch/journals/bclawr/42_1/02_TXT.htm).

4.1 Rights of merits review

The availability of merits review rights is a crucial aspect of good policy that seeks to preserve incentives for efficient investment in infrastructure while pursuing other social goals.

The availability of merits review rights is integral to the preservation of investor confidence for at least two reasons.

First, regulators at first instance can and do "get it wrong". An obvious example of this can be seen in the recent decision of the Australian Competition Tribunal, which held that the National Competition Council had wrongly decided that the Eastern Gas Pipeline should be regulated under the provisions of the National Third Party Access Code for Natural Gas Pipeline Systems.[19] Without rights of review, the scope for investors that are adversely affected by regulators' decisions to seek redress is severely curtailed (discussed further below). While this is a simple point, it is not at all a trivial one. In the context of Australian infrastructure regulation, the importance of the point is highlighted by the sheer magnitude of the assets that are affected by access regulation – at last reckoning, NECG valued such assets at over A$130 billion.

Secondly, merits review rights contribute to the development of a "high level" body of precedent that guides industry participants, including investors, about the likely nature of regulation that will apply to them in the future. This is an attribute that is worth further comment.

The reality of Australia's federal system of government is that there are a multiplicity of regulatory regimes, and a multiplicity of regulatory bodies that are involved in the overall administration of regulation. This is certainly true of Australia's access regimes, in which there are both State and Territory regulators and Commonwealth regulators, as well as different regulatory and legislative instruments applying in different industries. For example, different regulatory instruments govern access arrangements in the gas, telecommunications, electricity, airports, rail and port industries.

Despite the existence of these different regimes and their individual regulators, there are

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19 *Duke Eastern Gas Pipeline Pty Limited* [2001] ACompT 3 (4 July 2001).

important commonalities. For example, a common problem faced by regulators in most industries is the correct approach to take to regulated firms' new investments when calculating the pricing of access by third parties to regulated firms' infrastructure.

Each year, Australian access regulators may make several decisions within each and every industry about the pricing of third party access. It is certainly fair to say that there is not perfect consistency in the nature of these decisions across the broad spectrum of industries that are regulated, ***even in instances where there is a common regulator (for example, the Commission) and even when there are common issues requiring resolution by the regulator***. Furthermore, inconsistencies are observed in decision-making within individual regulated sectors, including within telecommunications. In some cases, these inconsistencies may be attributable to, or at least partly rationalised in terms of, slight differences in the precise wording of the regulatory instruments. In other instances, it may simply be attributable to the fact that different people within the one organisation are responsible for making a decision. For whatever reason, the precedential value of regulatory decisions themselves has proven to be of very limited utility.

By contrast, reviews of regulatory decisions by bodies such as the Australian Competition Tribunal have a much greater precedential value. In part, this arises because it is in the fundamental nature of review bodies that such bodies consider themselves constrained by the doctrine of precedent; regulators, on the other hand, do not tend to consider themselves so bound. No less significantly, such reviews play an important part in bringing together the often disparate threads in the application of regulation, and laying down more general principles that may be relied upon by investors.

In addition, a review decision by the Australian Competition Tribunal in respect of a regulatory decision in one sector has an immediate "flow-through" effect to participants in another sector. A regulator in one sector is implicitly but effectively constrained to adhere to the principles laid down by the Tribunal, because of the obvious prospect that, upon review by the Tribunal, the principles that have informed Tribunal decision-making in one sector will be applied consistently across sectors (subject to any relevant differences). Thus, ***even without having to incur the expense of their own appeals, investors gain the benefit of greater consistency in regulatory decision making, and are able to predict with far greater certainty what sorts of decisions regulators are likely to hand down. Confidence is enhanced, which makes it more likely that socially desirable investment will indeed occur.***

There is considerable support for this proposition in the experience of other sections of the Act. Thus, there can be little doubt that it is the crucial decisions taken by the Australian Competition Tribunal and its predecessor body, the Trade Practices Tribunal, while

exercising full review rights of administrative decisions, that have been the primary factor shaping and giving consistency to Australian law on authorisations in respect of mergers and other practices covered by Part IV of the Act. Tribunal decisions such as *QCMA*,[20] which clarified, in the face of at times uncertain administrative decision-making, the central meaning of the concepts of "competition" and "markets", are the basis on which Australian investors can confidently predict the proper implementation of the Part IV provisions. It is difficult to believe, and to our knowledge has never been seriously argued, that administrative decision-making would have sufficed to generate a stable and predictable body of practice in this area. Rather, the careful merits review work exercised by the Tribunal has played a crucial role in the success of Australian trade practices law.

Accepting the proposition that review of regulatory decision-making is appropriate, the question arises as to why the existence of appeal rights on questions of law and the potential for review in accordance with the AD(JR) Act is not adequate to meet that task. It is to this question that this submission now turns.

4.2 Merits review *vs* appeal rights on questions of law

So far, the argument has been made that review of regulatory decisions is essential, but it is important to realise that judicial review (that is, review on questions of law), whilst complementary to full merits review, is not an effective substitute for such review.

Leaving aside the difficulties that can arise in the area of competition law in distinguishing between questions of fact and of law, there are a number of reasons why judicial review alone should not be relied upon, including:

- first, the various economic analyses undertaken in respect of access coverage and pricing issues – and which are at the heart of many of the issues in contention between parties in this area – are not necessarily susceptible to classification as questions of law;
- secondly, even where this is not the case, the judiciary are not as well placed to determine economic questions as a specialised body such as the Australian

[20] *Re Queensland Co-operative Milling Association Limited* (1976) ATPR ¶40-012.

Competition Tribunal; and

- thirdly, although there is the possibility of the appointment of an independent expert to assist the court, such course of action is (a) discretionary on the part of the judge(s) involved; and (b) since the court cannot abrogate its judicial function to the independent expert, it will still be required to reach its own views and, as noted above, such issues are beyond the court's own competence.

4.3 Merits review *vs* AD(JR) Act review

Furthermore, contrary to the Commission's contention, review rights under the ADJR Act are simply not effective substitutes for full merits review by a body such as the Australian Competition Tribunal. Review under section 5 of the AD(JR) Act is limited to very specific grounds, a number of which address merely procedural matters in relation to the conduct of the decision-making or the legal basis for the decision.[21] Of those grounds for review under the AD(JR) Act which may be considered as being broader in scope,[22] it is strongly arguable

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[21] See sections 5(1)(a) (that a breach of the rules of natural justice occurred in connection with the making of the decision); 5(1)(b) (that procedures that were required by law to be observed in connection with the making of the decision were not observed); 5(1)(c) (that the person who purported to make the decision did not have jurisdiction to make the decision); 5(1)(d) (that the decision was not authorized by the enactment in pursuance of which it was purported to be made); 5(1)(f) (that the decision involved an error of law, whether or not the error appears on the record of the decision); 5(1)(g) (that the decision was induced or affected by fraud); or 5(1)(j) (that the decision was otherwise contrary to law) of the AD(JR) Act.

[22] See sections 5(1)(e) (that the making of the decision was an improper exercise of the power conferred by the enactment in pursuance of which it was purported to be made) and 5(1)(h) (that there was no evidence or other material to justify the making of the decision) of the AD(JR) Act. Note, in relation to section 5(1)(e) of the AD(JR) Act that section 5(2) of that Act provides that "improper exercise of a power" includes: taking an irrelevant consideration into account in the exercise of a power; failing to take a relevant consideration into account in the exercise of a power; an exercise of a power for a purpose other than a purpose for which the power is conferred; an exercise of a discretionary power in bad faith; an exercise

that the complexity of the decisions at issue would mean that a regulator would have little difficulty in overcoming any challenge on those grounds.

As such, review under the AD(JR) Act does not allow for a decision that is simply wrong in "fact" to be overturned. Furthermore, the criterion set out in section 5(1)(h) of that Act is really only applicable in situations where a decision maker has failed to support its decision with ***any*** evidence, not simply where the decision is just plain wrong.

This brief comparison of rights of appeal on questions of law and review under the AD(JR) Act with merits review shows that the latter is fundamentally different to these other rights. Each set of rights addresses a quite different function and, while they may be treated as complementary, they are not substitutes. Furthermore, merits review is a key element in ensuring the integrity of decisions and minimising the scope for regulatory overreach.

5 International comparisons

As noted in section 1, merits review of arbitration determinations under Part XIC of the Act is also entirely consistent with:

- the experience in the United States where the evolution of utility regulation through judicial review of the substance of decision-making has been a major contributor to

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of a personal discretionary power at the direction or behest of another person; an exercise of a discretionary power in accordance with a rule or policy without regard to the merits of the particular case; an exercise of a power that is so unreasonable that no reasonable person could have so exercised the power; an exercise of a power in such a way that the result of the exercise of the power is uncertain; and any other exercise of a power in a way that constitutes abuse of the power. Also note, in relation to section 5(1)(h) of the Act, that section 5(3) of the same Act provides that this ground is not made out unless the person who made the decision was required by law to reach that decision only if a particular matter was established, and there was no evidence or other material (including facts of which he or she was entitled to take notice) from which he or she could reasonably be satisfied that the matter was established; or the person who made the decision based the decision on the existence of a particular fact, and that fact did not exist.

private investor confidence in that sector; and

- the frameworks being adopted in other jurisdictions, such as the European Union.

Each of these is considered in turn.

5.1 United States experience

5.1.1 Rights of merits review

Contrary to the Commission's general inferences, it is not unusual in North American jurisdictions to submit cases to a complete re-hearing when the prior result is considered to be invalid.

In *AT&T Communications of Ohio, Inc. v Public Utilities Commission of Ohio,* the Supreme Court of Ohio noted that appeals from the decisions of public utilities commissions are not unusual and that rules exist to deal with this possibility:

> "Appeals of commission decisions are subject to the standard of review contained in R.C. 4903.13, which provides: "A final order made by the public utilities commission shall be reversed, vacated, or modified by the supreme court on appeal, if, upon consideration of the record, such court is of the opinion that such order was unlawful or unreasonable."[23]

This standard, the Court held, has been consistently interpreted in case law and establishes that commission decisions as to questions of fact can be reversed by courts where there is not sufficient evidence to show that the determination is "manifestly against the weight of the evidence and is not so clearly unsupported by the record as to show misapprehension, mistake, or wilful disregard of duty".[24]

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[23] *AT&T Communications of Ohio, Inc. v Pub. Util. Comm.*, 728 N.E.2d 371 (S Ct Ohio, 2000), 376.

[24] *AT&T Communications of Ohio, Inc. v Pub. Util. Comm.*, 728 N.E.2d 371, 376, quoting *MCI Telecommunications Corp. v. Pub. Util. Comm*. (1988), 38 Ohio St.3d 266, 268, 527 N.E.2d 777, 780.

The ability to conduct full merits review is evident in United States statutes as well. In the portion of the Code of Federal Regulations governing the activities of the Federal Communications Commission (the "FCC"), parties that disagree with a decision may appeal directly to the FCC. For example, in the case of the standards-setting and certification process for telephone equipment, the FCC may conduct a *de novo* review of technical criteria when requested to do so by aggrieved parties.[25]

The Federal Power Act of 1920 (US),[26] which regulates the activities of the Federal Energy Regulatory Commission (the "FERC"), establishes that parties can apply for rehearing of orders:

> "… Until the record in a proceeding shall have been filed in a court of appeals … the [FERC] may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it ..."[27]

The provisions of the Federal Power Act of 1920 (US) allow for some modification of the facts presented, if there is good reason for their exclusion in the first instance:

> "The finding of the [FERC] as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the [FERC], the court may order such additional evidence to be taken before the [FERC] and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The [FERC] may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or

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25 Federal Communications Commission, Report and Order, CC Docket No. 99-216 (released December 21, 2000), http://www.fcc.gov/Daily_Releases/Daily_Business/2000/db1228/fcc00400.txt

26 16 USC §791-828c, 10 June 1920.

27 16 USC §825I(a).

> new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order.[28]

In Canada, although determinations on factual matters by the Canadian Radio-television and Telecommunications Commission cannot be challenged in an appeal:

> "… the Commission may, on application or on its own motion, review and rescind or vary any decision made by it or re-hear a matter before rendering a decision."[29]

5.1.2 Analysis of public utility regulation experience

The scope for, and frequent recourse to, full review by the judiciary of United States regulatory decisions has played an important part in the evolution of the public utility industries in the United States. The wide interpretation given to the due process and takings protections provided by the United States Constitution have set crucial and strict limits on regulatory discretion. Most substantially, it has never been possible for United States regulators to substantively expropriate investors by forcing them to supply at prices that are below cost, without offsetting recompense – as the Commission is now seeking to do in respect of Telstra's Local Call Resale service. Additionally, the courts have been willing to set out in some detail the form of regulation, including in terms of costing methodology, that is appropriate and consistent with statutory and constitutional requirements. Significantly, it is recognised that where an issue is new, or where an agency is grappling with a problem which has not been previously settled, it is appropriate to ensure the scope for a "harder look" to be given by independent, judicial, review.[30] As a result, questions such as the setting of access charges have been well and truly subject to careful scrutiny by the courts.

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28 16 USC §825I(b).

29 Telecommunications Act, Statutes of Canada, Chapter 38, sections 64(5), 62.

30 See for example Edley, *Administrative Law* (1990) 48 and following.

Scholars have long recognised that the substantive scope for review of regulatory agency decision-making has been pivotal in providing the United States system with both predictability and adaptability. Both of these are central to economic efficiency.

Thus, predictability of regulation, within a set of arrangements that protect property rights, has allowed sustained high levels of investment, and provided an important stimulus to innovation in regulated industries.

At the same time, the decentralised nature of the regulatory process, in which agency decisions are subject to review, has meant that change could occur even in agencies that were highly resistant to it. Indeed, virtually all the landmark decisions in United States telecommunications policy have been made, not by the regulatory agencies, but by the courts, either directly or in reviewing and amending agency decisions.[31]

As elsewhere, there have frequently been complaints that the resulting multi-layer process is too lengthy or complex. However, infrastructure assets often have lives of 20 years or more and very high "first in" costs; moreover, they involve services for which there are generally few substitutes and where inadequate supply is not self-correcting. Getting crucial decisions wrong therefore has substantial consequences for long periods of time. Reflecting this, the broad consensus in United States regulatory policy has been and remains that decisions such as those at issue here merit, and indeed require, careful and deliberate review.[32]

5.2 Other jurisdictions

5.2.1 European Union

In its Submission, the Commission makes serious errors of commission and omission with respect to the situation in Europe.

Turning first to what are plain errors of fact, the Commission comments on the current European *Proposal for a Directive of the European Parliament and of the Council on a common*

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31 See generally, Brock, *Telecommunications Policy for the Information Age* (1994).

32 See generally, Komesar, *Imperfect Alternatives* (1994).

regulatory framework electronic communications networks and services,[33] to which all relevant European nations will be subject. That proposal requires that full review on the merits of regulatory decisions be available in all Member States. Article 4 of the Directive relevantly states that:

> "1. Member States shall ensure that a mechanism exists at national level under which a user or undertaking providing electronic communications networks and/or services has the right of appeal against a decision of a national regulatory authority to a body that is independent of government and the national regulatory authority concerned. The appeal body shall be able to consider not only the procedure according to which the decision was reached, but also the facts of the case. …
>
> 3. Where the appeal body is not judicial in character, written reasons for its decision shall always be given. Furthermore, in such a case, its decision shall be subject to review by a court or tribunal. …"

The Commission seeks to give this Committee the impression that the inclusion of merits review rights in the proposed Directive was somehow new, contentious and may not, indeed, survive finalisation of the Directive. This impression is simply without foundation.

In fact, as the Commission must well know, the inclusion of full rights of review, on facts and the law, has been contemplated as part of the proposed Directive ***from the very beginning***. This is evidenced by the initial working documents of the European Commission itself.[34] Furthermore, following the first reading of the proposed Directive in the European

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33 European Commission, *Proposal for a Directive of the European Parliament and of the Council on a Common Regulatory Framework for Electronic Communications Networks and Services*, (2000/C 365 E/14), OJ C365 E/198, 19 December 2000 (available at: http://www.conformity-update.com/eu-framework-010105.pdf).

34 See, DG Information Society Working Document, 27 April 2000 (available at: http://europa.eu.int/ISPO/infosoc/telecompolicy/review99/wdregfwk.pdf) in which the Commission outlined the key considerations upon which it intended to base the preparation of the proposals for directives that will constitute the updated regulatory framework, including full review rights.

Parliament, the proposed Directive was clarified and strengthened on this very issue in response to concerns expressed by the European Parliament.[35]

In addition, NECG notes that the Independent Regulators Group,[36] in commenting at length on the proposed new framework and associated instruments, made no comment on the provision of full merits review rights in the proposed Directive, thus seemingly endorsing the approach taken.[37]

Hence, the inferences raised by the Commission that full appeal and merits review rights are new, contentious – and possibly even unlikely to survive finalisation of the Directive – are entirely implausible.

Furthermore, European developments with respect to the proposed Directive serve to bring Europe into line with the position existing in the United States and Canada (discussed above).

Turning to the more general issue of omission, the Commission has, in this context as in others, sought to point to provisions in European countries that make for administrative law review of particular regulatory decisions as supporting its claim that it ought to be free of full merits review. In making this argument, the Commission ignores the well-known distinction between administrative law review as it operates in jurisdictions of civil law on the one hand and in the English tradition on the other.

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35 Refer notes accompanying: European Commission, Amended proposal for a Directive of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, Brussels, 4 July 2001, COM (2001) 380 Final, 2000/0184 (COD) (available at: http://europa.eu.int/information_society/topics/telecoms/regulatory/new_rf/com2001-380en.pdf). These notes provide marked up text of the relevant changes made.

36 The Independent Regulators Group comprises the telecommunications regulators of all European Union states, along with Iceland, Liechtenstein, Norway and Switzerland.

37 See: Independent Regulators Group, IRG Common Position on Commission working documents dated 27 April 2000 (available at: http://europa.eu.int/ISPO/infosoc/telecompolicy/review99/nrfwd/IRG23e.htm).

In continental European systems, there has traditionally been little or no scope for the concept of an "independent" regulatory agency. This is not because agencies could not operate free from political interference; rather, it is because the doctrine of unity of state action requires that agency decisions be no less subject to review than any other administrative process.[38] This review is exercised through bodies like the French *Conseil d'Etat*, which have powers that go to full review of the decision.[39] In this respect, continental administrative law provides, as a matter of course, for a right of review of administrative decision-making that goes far beyond that contemplated in English or for that matter Australian, administrative law.[40] As a result, it is completely misleading to point to continental experience with reliance on administrative law as a basis for making claims about the proper scope of administrative law in the common law jurisdictions.

No less significantly, it needs to be recognised that the development of Community law has provided further important channels of review of administrative decision-making by Member States of the Union. Thus, as has been made clear by proceedings such as those successfully prosecuted by Telecom Italia in respect of the price caps imposed on it, a private subject that is affected by regulation, can turn to the European Court of Justice to review the consistency of that regulation with the substance of European directives. Moreover, the decision of the Court is binding in respect of the Member State. To the extent to which decision-making within a State is confined by the terms of a directive, than a *de facto* right of full review is provided.

In short, far from the situation in Europe providing any support for the Commission's approach, the reality is as follows:

- in the continental legal systems, there already typically exists as part of the system of administrative law, a right of full review of agency decisions;

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38 Colliard and Timsit, *Les Autorites Administratives Independantes* (1988).

39 See generally Brown and Bell, *French Administrative Law* (4th ed, 1992).

40 A detailed examination can be found in Allison, *A Continental Distinction in the Common Law: A Historical and Comparative Perspective on English Public Law* (1996).

- the increasing role of European directives in guiding national decision-making, and the scope for review of implementation through the European Court of Justice, provides for a further right of review; and finally,

- it is now proposed, and has been widely accepted, that as part of the telecommunications directive currently being finalised, a formal right of full merits review will have to be provided in all Member States.

5.2.2 New Zealand

The Telecommunications Bill 2001 (NZ) (the "Bill") – currently before the Commerce Select Committee and due to report by 2 October 2001 – similarly recognises the need for review of pricing determinations.

Clause 17 of the Bill provides for an access seeker or access provider to apply to the Commerce Commission for a determination of all or some of the terms on which the relevant service must be supplied. Subpart 4 of Part 2 of the Bill allows a party to a determination to apply to the Commission for a review of that part of the determination that relates to the price to be paid for the service. Clause 49 of the Bill sets out very broad powers and requirements as to the processes in reaching determinations. Clause 56 of the Bill provides for appeals to the High Court of New Zealand in respect of any such determinations.

Although the merits review provided under the proposed New Zealand regime does not equate with the procedural processes existing in Australia, nonetheless NECG considers that the New Zealand case represents a considerable advancement in terms of merits review because:

- the proposed regime establishes detailed and prescriptive rules regarding pricing for designated services, both in terms of initial and final pricing principles. This provides significantly less scope for dispute between the parties (since the methodology is essentially laid out in advance) and, equally, significantly less scope for the regulatory authority to make price determinations on the basis of indeterminate and changing criteria;

- it is understood that, as the proposed legislative regime sets out objective pricing tests (that is, specific pricing rules that must be applied), a party could apply to a court for a declaration as to whether a test is satisfied in a particular instance or not. This contrasts with the Australian regime under which decisions about access prices are to be determined by reference to whether the Commission is satisfied as regards

particular matters. Thus, the scope of review rights is broader than apparent at first glance;

- the regime provides a multi-tiered system for establishing, and resolving disputes in relation to, access prices:
  - commercial negotiation in the first instance between the parties;
  - a form of "preliminary determination" by the regulatory authority where requested (it is understood that this is intended to be an expedited process to allow for early resolution of disputes). Unlike the Australian arbitration regime, this process is a public one and provides for public submissions;
  - the potential for formal *de novo* review of said preliminary determination, which again provides for public submissions (and consultations and conferences with parties having a material interest in the matter) in respect of the draft price review determination. The regulatory authority is also required to publish reasons for any final price review determination made. The regulatory authority is also required, as soon as practicable after completing any consultations or conferences, to prepare a final review determination and cannot simply allow draft determinations to stand;
  - in relation to the various types of determinations briefly described above, the regulatory authority is required to consider all submissions and all information and opinions presented or expressed at any conference or public hearing in relation to the determination;
  - determinations may subsequently be clarified, reconsidered, revoked or amended;
  - appeals on questions of law may be made to the High Court of New Zealand; and
  - decisions of the High Court of New Zealand may be appealed to the Court of Appeal if leave is given by either the High Court or the Court of Appeal; and
- although the Bill allows the Commission to regulate its own procedure, NECG understands that New Zealand administrative law would require the Commerce Commission to establish the substantive independence of any review process

initiated in relation to price review determinations, so that any mere "Clayton's review" would be vulnerable to challenge.

In summary, two key features of the proposed New Zealand regime are notable:

(a) even in the notoriously light-handed regulatory environment in place in New Zealand, the importance of providing for full review rights has been recognised; and

(b) such review rights have been considered important, even though the Bill provides for a significantly more prescriptive approach to the pricing of access services and therefore might otherwise be thought to be less contentious than the regime operating in Australia.

6 Conclusion

Considerable work undertaken by and for the World Bank over a period of years has noted that there is a general consensus that certain kinds of accountability are necessary features of a sound system of government and administration, including appeals to courts on issues of legality and appeals to internal and external bodies on the substantive merits of decisions.[41] Additionally, there is now very substantial evidence that countries whose institutional arrangements conform to such a pattern, and thereby protect investors from regulatory expropriation, experience higher and more sustained economic growth.[42]

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41 See, on the principal institutions and mechanisms of accountability, http://www1.worldbank.org/publicsector/legal/DenisGalligan.pdf

42 See Brunetti and Weder, *Political Credibility and Economic Growth* (1992), Barro, R.J. (1991) ''Economic Growth in a Cross Section of Countries.'' *Quarterly Journal of Economics* 106: 407–43; Barro, R.J., and Sala-i-Martin, X. (1995) *Economic Growth*. New York: McGraw-Hill; Goldsmith, A. A., 1995. "Democracy, property rights and economic growth", Journal of Development Studies, 32 (2): 157-174. Knack, S. (1996) ''Institutions and the Convergence Hypothesis: The Cross-National Evidence.'' *Public Choice* 87: 207–28; Knack, S., and Keefer, P. (1995) ''Institutions and Economic Performance: Cross-Country Tests Using Alternative

This, it is submitted, is unsurprising. A system that exposes those who finance long-lived assets to untrammelled regulatory discretion cannot but deter investment and harm economic growth.

NECG believes these considerations are of special importance in the Australian context. As a relatively small economy occupying an extremely large land mass, with a dispersed population and an abundance of natural resources, Australia is almost uniquely dependent on its infrastructure industries. Efficient investment in infrastructure is crucial if the prosperity of Australians is to be assured. That investment will not be forthcoming if investors cannot be confident of earning reasonable returns on socially desirable infrastructure projects. Regulatory discretion, exercised with little substantive constraint, is completely inimical to that confidence. In contrast, international experience has shown time and again that subjecting regulatory agencies to full judicial review can help rein that discretion in and thereby contribute to creating an environment in which needed investment will be forthcoming.

Further accentuating the significance of these considerations in Australia's circumstances are the unique features of Australian regulatory arrangements. Australia is, in effect, virtually alone in concentrating national regulatory powers in a single entity – the Commission. In other federal systems, such as Canada and the United States, jurisdictional separation on a territorial level is paralleled by divided regulatory jurisdiction (typically through demarcations along industry lines) at the national level. In contrast, in Australia, there is effectively a sole entity at the Commonwealth level – the Commission – that regulates across an extremely wide range of industries.

There can be gains to such an arrangement, but there must also be legitimate concerns about maintaining substantial disciplines and accountability. The Commission's recent strong campaign for its regulatory decisions to escape merits review – in stark contrast to the situation under Part IV of the Act – seems to seek to materially weaken those disciplines and

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Institutional Measures.'' *Economics and Politics* 7: 207–27; Keefer, P., and Knack, S. (1997) ''Why Don't Poor Countries Catch-Up? A Cross-National Test of Institutional Explanations.'' *Economic Inquiry* 35: 590–602; Scully, G.W. (1992) *Constitutional Environments and Economic Growth*, Princeton University Press; Torstensson, J., 1994. "Property rights and economic growth - an empirical study", Kyklos, 47 (2): 231-247.

that accountability. It is submitted that there is no basis in sound administration for moving in the direction the Commission proposes.

Australia, which is exceptionally dependent on efficient infrastructure investment if it is to prosper, should be wary of moving in a direction that may suit the regulator but does little for the community as a whole.