

**Contemporary Issues in Regulatory
Theory and Practice**
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**The Merits of a Merits Review
Process for Regulatory Decisions:
Why New Zealand Should Have It**

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Outline

- **The regulatory process**
- **What does the law say – objects and principles?**
- **Can there ever be a 'correct' regulatory decision?**
- **Regulatory error and its consequences**

Outline (continued)

- **Regulatory accountability and review of error**
 - **judicial review**
 - **merits review**
 - **further appeals**
- **The benefits and costs of merits review**
- **Establishing precedent through merits review**
- **How do regulators respond to merits review?**

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Outline (continued)

- **What is the best merits review mechanism?**
 - **principles**
 - **procedures**
 - **review material**
 - **composition**
- **Setting up a merits review mechanism**
- **Conclusions**

The regulatory process

- **Market failure and government failure**
- **Objectives, benchmarks, principles and assumptions: the law and in practice**
- **Prescription versus discretionary powers**
- **No unique correct answers – a balancing act**
 - **consumers and producers**
 - **short run and long run**
 - **constraints and incentives**

What does the law say – objects and principles?

- The need for a clear over-arching objects clause
- Other objectives should be compatible with this – beware conflicting goals like NPB v. NAB
- Prescription versus discretionary powers
- What is the benchmark performance?
- Acceptable principles, models, assumptions, roles
- eg propose/respond or submit/determine regimes

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Can there ever be a 'correct' regulatory decision?

- **In the absolute, no**
- **Debate over facts, models, assumptions, relevant time period, limited data availability, legislative goals, triggers, amount of regulatory discretion, etc**
- **Correct for which party/stakeholder?**
- **What should the role of the regulator be – to initiate or to assess?**
- **The need for public hearings and open debate – the regulator as a facilitator and mediator of experts**

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Regulatory error and its consequences

- A state of no regulatory errors is unlikely
- What should be the regulator's null hypothesis? Type 1 and Type 2 errors
 - which is worst?
 - short run and long run consequences
 - static, allocative and dynamic efficiencies
- Costs of regulatory error are sunk
- Is the regulator the 'expert' and thus to be overturned only rarely?

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Regulatory accountability and review of error

- Natural justice demands accountability and transparency
- No regulator (or even an appeal body) has a monopoly on wisdom
- The right to appeal is the sine qua non of fair regulation
 - **judicial review**
 - **merits review**
- Even regulators agree – at least in Australia!

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Judicial review

- Can be used to correct errors of law or wrongful use of power by a regulator – the search for 'institutional integrity'
- Cannot make substitute decisions – can either affirm, or quash and remit
- Sought when the law is highly prescriptive
- Should not be used for an appeal on the facts
- A complement to merits review, not a substitute – they are mutually exclusive

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Merits review

- **A review by an independent expert body of the use by a regulator of its discretionary powers**
- **Such discretion is inevitable – it is not possible for legislation to foresee all possibilities**
- **Was the decision in error, or was the use of discretion incorrect or unreasonable, or was it not a situation where the exercise of discretion was called for?**

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Merits review

- Provides precedent leading to greater transparency, accountability, efficiency, learning, consistency and predictability in regulation, providing better signals for regulated companies
- A variety of outcomes are possible - merits reviews can affirm, reverse, remit or substitute a decision by 'standing in the shoes' of the regulator
- Such outcomes are not available under judicial review

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Merits review

- **What information can be considered by the appeal body – it is not a *de novo* hearing**
- **Merits review is available to any interested party**
- **Does merits review encourage regulatory gaming or forum shopping?**
- **Is the regulator an expert body to be deferred to?**
- **What, in any, constraints should be imposed on merits reviews?**

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Merits review

- **Can merits review hold things up? Not if the decision is not stayed**
- **Merits reviews have not been frequently sought in Australia to date**
- **However, a lot of reviewable error has been found, especially under the Gas Pipelines Access laws**

Further appeals

- **On what grounds should a merits review decision be appealable?**
- **What is an appropriate appeal body?**
- **Should new material ever be admitted?**
- **The need for binding precedent**
- **Appeals must be expedited**
- **Regular reviews of the law and its operation are essential**
- **If the law is a problem it should be changed**

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The benefits and costs of merits review

- What is the nature of the error?
- Can it be easily identified and rectified?
- Private benefits and costs
 - higher rate of return
 - more investment possible
 - better access to capital markets
 - less uncertainty
 - expense
 - closer future scrutiny by regulator

The benefits and costs of merits review

- **Social benefits and costs**

- precedent and clarification
- greater investment may follow
- legitimise the regulator's decision
- an independent assessment
- costs of regulatory gaming and forum shopping
- maverick regulatory decisions
- conservative regulatory decisions
- expenses imposed on the regulator

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Establishing precedent through merits review

- **Regulators' decisions are situation-specific**
- **Certainty as to correct practice and interpretation by the regulator only comes from independent endorsement, unless the law is highly prescriptive**
- **Regulatory best practice is not static - new paradigms, models, theories etc need to be considered on appeal**

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How do regulators (and others) respond to merits review?

- Regulators should not fear review, nor feel reluctant to take a stand
- Does the existence of merits appeals cause regulators to become more conservative, or more radical?
 - how to handle paradigm changes
 - security of tenure

How do regulators (and others) respond to merits review?

- **Regulators in Australia welcome the existence of merits review**
 - **Ed Willett, Commissioner, ACCC**
 - **John Tamblyn, Chair, ESC of Victoria**
- **The Productivity Commission in its review of the Gas Access Regime strongly supported a merits review process, as did many submissions to the review**

What is the best merits review mechanism?

- Principle types of error to be considered
 - error
 - unreasonable use of discretion
 - discretion used when not called for
- Procedures to be followed
- Material that can be considered
 - only what was before the regulator plus transcripts
- Composition of the appeal body
 - need for precedent – judicial member
 - expert lay members

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Setting up a merits review mechanism

- Different models in different jurisdictions – there is no one-size-fits-all model
- A series of specialist panels or one body – consistency issues
- Experts are essential
- Judicial presence is necessary
- Secretariat services
- Should the judge have the final say?
- What material can be presented?
- Do the parties' experts get another go?

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Conclusions

- **The law should have carefully articulated objectives and principle to be followed**
- **An open and transparent regulatory process is essential**
- **Even then, regulatory error can occur – regulators are not infallible**
- **Natural justice demands accountability via judicial or merits review – but they**

are complements not substitutes University of South Australia

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Conclusions (continued)

- **Many alternative models are available for merits review**
- **Merits review keeps regulators on their toes, promotes regulatory and commercial learning, and provides precedent and greater certainty**
- **Very few countries do not have some form of merits review for regulators' decisions – surely NZ regulators are not so perfect that review is unnecessary?**