The Merits of a Merits Review Process for Regulatory Decisions: Why New Zealand Should Have It

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• 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?
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
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
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?
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!
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
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?
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
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?
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
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
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.
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
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
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?
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
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?