

Independent Panel questions to the AER

Dates of correspondence: 3-12 July 2018

Correspondence between: Natalia Southern (Chair of Panel), Tanja Warre and Pradeep Fernando ((Directors – Rate of Return – AER)

*Please note the Panel's requests/comments are in **black** text and the AER's responses in **blue**.*

The Independent Panel (**Panel**) wrote to the AER regarding the following:

1. Relevant documents that may assist the Panel in interpreting issues of "sound reasoning" and "available information"

- The Panel is giving consideration to the framework and approach that it will adopt in conducting its assessment.
- Without having to delve into previous appeals/litigation documents, we would be keen to understand the extent to which any previous proceedings may have considered questions about what constitutes sound reasoning and available information - which may provide some guidance to us.
- We would appreciate if you could direct us to any relevant cases either from the Tribunal or from Australian courts describing a legal duty to a regulatory body's requirement to consider evidence and explain its decisions and any administrative law statute that addresses these issues. Any factual summaries that the AER may have prepared on these cases would be appreciated to save us having to read a lot of material.
- As a general rule, the panel should give the words their ordinary meaning. The task of the independent panel is not intended to be a legal review of the decision, or a legalistic review, but rather the panel is providing independent advice on the AER's decision.
- There are previous considerations around this topic. Limited Merits Review (which was abolished in late 2017), and the legal framework around that, included grounds for review. While the panel is not undertaking a review in the same form as the Competition Tribunal, there are some high level principles in Tribunal decisions and court cases that the panel may wish to consider in undertaking this review.
- Subject to the general observation that the panel should give words their ordinary meaning, concepts such as 'reasoned' or 'unreasonable' have been considered by Courts and Tribunals, in the context of reviewing decisions on the merits. Some of those observations might be helpful in providing some general guidance.
- In Application by EnergyAustralia [2009] ACompT 7, the Competition Tribunal made the following comments about an appropriate way for a decision-maker to approach how it gives reasons and the reasoning involved. The Tribunal said:
- A decision maker like the AER is required to deal with the substantial points raised, make findings on material questions of fact, refer to the material upon which findings are based, and provide an intelligible explanation of the process of reasoning leading to the ultimate conclusion.

- In Application by AusNet Electricity Services Pty Ltd [2017] ACompT 3, the Competition Tribunal noted that there is a difference between a decision lacking reasoning and a decision being one on which reasonable minds might differ. The Tribunal said at [52]-[53]:
 - 52 AusNet’s claim that the AER incorrectly exercised its discretion in taking the average of the two curves was put essentially on the same basis as the claimed error or errors of fact. In our view it fails for the same reasons.
 - 53 We reach the same conclusion in relation to AusNet’s submission that the AER’s decision lacked reason, was unreasoned, and was unreasonable in the result. In our opinion the AER’s decision was one on which reasonable minds might differ, but that does not establish that the decision was unreasonable. Indeed, in our opinion, the AER’s decision was both reasoned and reasonable.
- The notion that reasonable minds might differ about conclusions based on the same facts is often repeated in legal authorities. The High Court has noted that a decision-maker can be presented with alternative and potentially conflicting evidence and suggested the way for the decision-maker to approach this will involve either weighing up relevant facts and determining the correct result, or making:
 - “value judgments in respect of which there is room for reasonable differences of opinion, no particular opinion being uniquely right”: per Mason and Dean JJ in *Norbis v Norbis* (1985-1986) 161 CLR 513 at 518.
- In the context of energy determinations, the Competition Tribunal recently put the matter this way (see Applications by CitiPower Pty Ltd and Powercor Australia Ltd [2017] ACompT 4 at [136]):
 - The errors alleged go to the merits of the reasoning: they are matters on which reasonable minds may differ but they remain within judgements reasonably open to be made by the AER. We accept the submission that there is nothing illogical in judging that the use of appropriate forecast benchmarks will create incentives for service providers to meet or beat those benchmarks, thereby increasing efficiency over time. It was open to the AER to consider that a benchmark approach was suitable to creating appropriate incentives and that it was important to have a consistent approach to a benchmark.
- There have been some administrative law cases that have dealt with the need of a decision-maker to give reasons for its decisions where the Court has discussed the underlying purpose of that requirement to provide reasons. For example, in *Martin v Australian Postal Corp* (1999) 29 AAR 420 the Federal Court stated:
 - The essence of the requirement that the Tribunal give reasons is that its decision must be understandable. Two purposes are thereby served. The first is that a party concerned may be able to see the basis of the decision, and whether it is legally sound, or affected by some error. The second is that the discipline of the necessity to render reasons helps to keep any tribunal on the path of sound reasoning to sound conclusions.
- This latter point, that quite apart from legal requirements, the decision-maker’s decision needs to be supported by sound reasoning that leads to sound conclusions has a similarity to the general object of the independent panel’s assessment.
- The following cases consider potential problems with reasoning:
 - a decision that contains logical error or irrationality: Application by APT Allgas Energy Pty Limited (No 2) [2012] ACompT 5 at [51], citing *ACCC v ACT* [2006] FCAFC 83 at [178]; Ausgrid [2016] ACompT 2

- a decision that is arbitrary: Application by Energy Australia [2009] ACompT 8 at [67]; ActewAGL [2010] ACompT 4 at [35]
 - a decision that is not determined by reference to the applicable criteria in the NEL or the NER: Application by Energy Australia [2009] ACompT 8 at [68], cited with approval in Application by United Energy Distribution Pty Limited [2012] ACompT 1 at [49]-[50], Envestra at [52], Allgas at [54] and ATCO Gas at [45]; or
 - a decision where there has been a failure to take into account a matter which was required to be considered, or consideration of a matter which was irrelevant: Application by APT Allgas Energy Pty Limited (No 2) [2012] at [54]; [2010] ACompT 4 at [35]
- Ultimately, however, it will be a matter of judgement for the panel whether the decision is supported by sound reasoning on the available information, giving those words their ordinary meaning as understood by the panel.

The Panel requested some further information about the nature of information that the AER has or has not had regard to in developing the draft guideline.

If the answers to these questions are contained in the draft guideline or other documents that will be released tomorrow, then please refer to the relevant document, sections or page numbers. If not, then we would appreciate your written response.

2. Does the AER consider that it has considered all of the available information in preparing the draft guideline?

- The AER has regard to all of the information that is submitted to it as well as other information it considers relevant to making a considered decision. All of the information considered is set out in the explanatory statement including submission summary tables in specific attachments. All information is referenced via footnotes to the source document.
- We will shortly provide the panel a list of all the reference material relied on in the explanatory statement with hyperlinks to the relevant documents.
- The AER noted that it has regard to all of the information that is submitted to it as well as other information it considers relevant to making a considered decision. All of the information considered is set out in the explanatory statement.

3. What information has the AER considered and/or what process has it adopted in ensuring that it has considered all available information in preparing its draft guideline?

- The AER set up a process which started in August 2017 to ensure that it captures the widest possible sources of information. The process has included:
- Consultation paper and invitation for submissions on process for reviewing the rate of return guideline, July 2017.
 - Stakeholder Forum on upcoming Issues Paper, September 2017.

- Position paper - Process for the guideline review, September 2017
- Issues paper and call for submissions - Review of the rate of return guideline, October 2017.
- Discussion papers on a number of specific topics and invitation to make submissions, February –May 2018
- Two separate expert concurrent evidence sessions, transcripts and report published with opportunity to make submissions on these session discussions and report
- Numerous engagement meetings with reference groups constituted for this review. These are the Consumer Reference Group, Investor Reference Groups and Retailer Reference Group.
- Submission from the AER’s Consumer Challenge Panel.
- All of the above papers, submissions and engagement meeting notes are available on our website. As noted in response 1 above, how this information has been considered is set out in the explanatory statement.
- We also note that this 2018 review continues from the 2013 Guideline and in that context has had regard to material and debate since 2013 and referenced at relevant points in the explanatory statement.

4. Is there any information that has been provided to the AER that it has not had regard to in preparing the draft guideline? If not, why not?

- The AER has not explicitly decided to not have regard to any information. To the extent any material does not play a role in informing the AER’s exercise of judgement this is set out in the explanatory statement reasons. For example see Figure 10 and Table 17 in attachment 5.
- There was some material that has been provided/received by the AER late in the process. We have had regard to this information to the extent that the available time permitted. These include:
 - ENA submission to the AER Board on the exercise of discretion in estimating the MRP
 - ENA presentation and CEG Memo on analysis of debt
 - ENA’s cover letter and revised Hathaway report on ATO data
 - Note of meeting between the ATO, stakeholders and AER
 - Martin Lally’s report on the distribution of imputation credits
 - Correspondence between the AER and the Reserve Bank of Australia.
- We note that we are currently uploading supporting material on to our project website and this will be completed in the next couple of days.

5. Has the AER been provided with confidential or commercially sensitive information that is not available on its website and/or has not been explicitly referenced in the draft guideline or accompanying documents?

How has this information been considered in preparing the draft guideline?

- The AER has regard to confidential information. The majority of material relied on by the AER is in the public domain. The confidential material largely falls into two categories.
- The first category is information/data that is sourced from third party data providers/market practitioners. We have aggregated and generalised this data in our explanatory statement to protect the proprietary nature of the data. We have sought clearance from the data providers for the information published in the explanatory statement.
- The second category is commercially sensitive actual debt data we collected from a majority of privately owned regulated networks. We have aggregated and generalised this data and presented high level material in our explanatory statement. We have held separate one-on-one meetings in confidence with service providers to test our analysis of the data (see discussion on page 61).
- Both categories of confidential material have informed the AER's decision. Under the confidentiality undertakings signed by the independent panel members we can provide you with confidential information on request.

6. How has the AER satisfied itself that it has considered the latest thinking and developments in corporate finance and regulatory practice in preparing its draft guideline?

- This was a topic that we explored with stakeholders early in the process and the broad view was that the overall framework employed by the AER remains appropriate. For example, see the discussion commencing on page 29 of the overview on the scope of our review. We have further tested our approach through the expert concurrent evidence sessions and through submissions and expert reports.
- The proofed transcripts of the evidence sessions 1 and 2 and the expert evidence sessions joint report are available [here](#).

7. Has the AER commissioned any additional reports to assist it in developing the draft guideline? If so please advise what reports have been prepared and whether they have been made publicly available?

- All of the reports commissioned by the AER are available on our website. The reports prepared for the AER in this review and already on our website are:
 - Dr Lally report - Review of the AER's Views on Gearing and Gamma - 7 May 2018
 - Partington and Satchell - Report to AER Rate of Return Guideline - May 2018
 - Chairmont - Aggregation of Return on Debt Data report - 28 April 2018
 - Chairmont- Letter- Response to Consultant's Questions Final 4 June 2018

Further to the correspondence above, on 16 July 2018 the AER provided the panel with information on how to use the AER's secure file share system. The AER sent the panel a document via secure file transfer that contained a list of documents referenced in the explanatory statement of the draft guidelines.