Network of Illawarra Consumers of Energy

AER Consultation Paper on the use of Concurrent Expert Evidence and the Independent Panel

July 2021

Network of Illawarra Consumers of Energy

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Summary

This submission is made by the Network of Illawarra Consumers of Energy (NICE), a recently formed entity advocating for the energy transition to a net-zero carbon future to be managed with the interests of consumers at the heart.

Concurrent Expert Evidence Sessions (or Hot-Tubs) developed in the Australian courts as a response to identified bias on the part of expert witnesses and to overcome some of the issues that had made some practitioners reluctant to be called as experts.

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Glossary

ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
ARoR	Allowed Rate of Return
Beta	Parameter used in the CAPM to determine the relative volatility of a financial return compared to the market return
CAPM	Capital Asset Pricing Model
Collective	The collective of energy ministers that has previously gone by the names of the Ministerial Council on Energy, the Standing Committee on Energy and Resources, and the COAG Energy Council but now apparently is the National Cabinet Energy Committee and the Energy Ministers Meeting (See Appendix 1)
CRG	Consumer Reference Group
ECA	Energy Consumers Australia
ENA	Energy Networks Australia
LMR	Limited Merits Review
MRP	Market Risk Premium – used in the CAPM to measure the amount by which the return on a market portfolio of assets exceeds the risk free rate.
NEO	National Electricity Objective
NICE	Network of Illawarra Consumers of Energy
RoRI	Rate of Return Instrument

Introduction

The Network of Illawarra Consumers of Energy (NICE) is a recently formed informal network advocating for the energy transition to a net-zero carbon future to be managed with the interests of consumers at the heart.[1] This necessary transition needs to occur at least cost to consumers while maintaining reliability and security of energy services, appropriate consumer protections for essential services and a just transition for affected workforces.

We believe there is a role for regionally based advocacy within the context of nationally consistent energy policy. The choice and options for energy supply do differ by geographic region having regard to different climatic conditions affecting demand and supply options, and different risk factors impacting on resilience planning. This submission has been prepared by David Havyatt who is the sole author.[2]

We appreciate the opportunity to comment on the Australian Energy Regulator's (AER) *Pathway to the 2022 rate of return instrument: Consultation Paper on 2022 Instrument Process* of June 2021 (the Paper). The paper is consulting on the processes to be used for the Concurrent Expert Evidence Sessions (Sessions) and the Independent Panel (the Panel) in the 2022 RoRI process. The author was a member of the Consumer Reference Group (CRG) for the 2018 RoRI and as Senior Economist at Energy Consumers Australia (ECA) organised (and funded) two of the experts involved in the 2018 Sessions.

This submission has two substantive sections. The first covers the background to the matters being considered including the legislative provisions, the development of concurrent expert evidence sessions in Australia, how they are conducted in courts, and some comments on the 2018 RoRI process. The second considers the current process and begins with a consideration of where the Sessions and the Panel fit into the process, followed by comments on each process.

As well as responses to the consultation question posed in the Paper, we make observations on decisions the AER indicates it has already made. We submit that the AER should reconsider their expectations of the Sessions because the AER's judgement is not only about the values of individual parameters but of the decision as a whole. We also submit that the sessions should be conducted by an AER Board member rather than an ACCC Commissioner. In relation to the Panel, we submit that the AER should allow parties to identify to the Panel aspects of the Draft Decision they are concerned about in submissions of no more than two pages.

[1] The network has not yet started actively recruiting participants.
[2] Mr Havyatt was employed as Senior Economist at Energy Consumers Australia from October 2015 to August 2020. For the avoidance of doubt, nothing in this submission is the position of Energy Consumers Australia.

Background

Legislative Provisions

The Collective of Energy Ministers (the Collective)[3] in determining to replace repeated evidence and disputation on the rate of return for regulated networks decided to require the AER to make a binding Rate of Return Instrument (RoRI) that would not be subject to Limited Merits Review (LMR). In doing so, the Collective sought to institute some elements to ensure that there was some 'oversight' of AER processes.

To this end the legislative package that introduced the RoRI included a requirement for a Concurrent Expert Evidence Session and for a review of the AER draft by an Independent Panel (the Panel). Both these mechanisms were used in making the 2018 RoRI, and were reviewed in the review of that process conducted by Brattle.[4] The author was involved in the RoRI 2018 as both a member of the Consumer Reference Group (CRG) and as Senior Economist at Energy Consumers Australia. He was also interviewed for the Brattle review.

Development of Concurrent Expert Evidence Sessions in Australian Law

Concurrent expert evidence sessions are a procedure that is used in both courts and arbitrations. The practice in courts has its origins in Australia (where they are also known as Hot Tubs) and formally became part of English Courts in 2013.[5] In 2019 the Chartered Institute of Arbitrators published guidelines for their use in international arbitration.[6]

The legal genesis in Australia starts with the formalisation of 'expert evidence' in the uniform *Evidence Acts* beginning in 1995. As a consequence, the admissibility of expert evidence was regulated by s79 rather than common law. This provides an exception to the general exclusion of opinion from evidence[7], stating:

> *If a person has specialised knowledge based on the person's training, study or experience, the opinion rule does not apply to evidence of an opinion of that person that is wholly or substantially based on that knowledge.*

The courts rely upon the witness's 'training, study or experience' to provide the resultant 'specialised knowledge.' No other test is applied.

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[3] We use this term to refer to all the various incarnations of the group of energy Ministers that are responsible for the administration of the National Energy Laws.

[4] Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019

[5] Croke, A & Mallon, L 2013, Hot-tub: lessons from Australia, Ashurst, <https://www.ashurst.com/en/news-and-insights/legal-updates/hot-tub-lessons-from-australia-commercial-litigation-newsletter-october-2013/>.

[6] Arbitrators, CIo 2019, Guidelines for Witness Conferencing in International Arbitration.

[7] Martire, KA & Edmond, G 2017, 'Rethinking expert opinion evidence', Melbourne University Law Review, vol. 40, no. 3, pp. 967-98.

In a 1999 study 'judges identified partisanship or bias on the part of expert witnesses as an issue about which they were concerned and in respect of which they thought that there needed to be change.'[8]

Concurrent expert evidence sessions developed out of legislative reform 'such as the *Civil Procedure Act*, enacted in 2005 in New South Wales, which provides that "the practice and procedure of the court should be implemented with the object of resolving the issues between the parties in such a way that the costs to the parties is proportionate to the importance and complexity of the subject-matter in dispute."'[9]

The use of concurrent expert evidence sessions has been promoted by judges as a way to address bias and to encourage more experts to make themselves available.

Rares J notes that 'Courts have struggled for a long time with the consequences of the use by each party, in the adversarial system, of an expert whose evidence, at least in chief, favours that party… Concurrent evidence is a means of eliciting expert evidence with more input and assistance from the experts themselves in lieu of their, perhaps unfairly, perceived role as being inherently, even if not consciously, biased to the case of the party calling them.'[10]

McClellan J has observed:

> *One consequence of the adversarial system is that witnesses, including many experts, consciously or unconsciously perceive themselves to be on one side or the other of the argument. Apart from the inefficiencies involved, the process discourages many of the most qualified experts from giving evidence. It is commonplace to hear people who have much to offer the resolution of disputes—doctors, engineers, valuers, accountants and others—comment that they will not subject themselves to a process which is not efficient in using their time. It is equally common to be told that the person will not give evidence in a forum where the fundamental purpose of the participants is to win the argument rather than seek the truth. A process in which they perceive other experts to be telling "half truths" and which confines them to answering only "the questions asked" depriving them of the opportunity, as they see it, to accurately inform the court is rejected as "game playing" and a waste of their time.*[11]

On both these points it is worthwhile for the AER to reflect on how many academics in Australia teach and research in Finance, and yet how few make themselves available as experts in proceedings on determining rates of return. As well as the issues identified by McClellan, we also

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[8] Freckelton, IR, Reddy, P & Selby, H 1999, Australian judicial perspectives on expert evidence: An empirical study, Australian Institute of Judicial Administration Incorporated Melbourne.
[9] Edmond, G 2009, 'Merton and the hot tub: Scientific conventions and expert evidence in Australian civil procedure', Law & Contemp. Probs., vol. 72, p. 159.
[10] Rares, S 2013, 'Using the" hot tub"-how concurrent expert evidence aids understanding issues', Intellectual Property Forum: journal of the Intellectual and Industrial Property Society of Australia and New Zealand, no. 95, pp. 28-36.
[11] McClellan, P 2007, 'Expert evidence: aces up your sleeve?[Edited version of a paper delivered at the Industrial Relations Commission of New South Wales, Annual Conference, 18-20 October 2006, Sydney.]', in Judicial Review: Selected Conference Papers: Journal of the Judicial Commission of New South Wales, The, vol. 8, pp. 215-32. as quoted in Edmond, G 2009, 'Merton and the hot tub: Scientific conventions and expert evidence in Australian civil procedure', Law & Contemp. Probs., vol. 72, p. 159.

note the weight of accumulated evidence in previous proceedings with which the small coterie of regular experts are familiar but have not otherwise concerned other experts.

We also note the ongoing imbalance between the resources available to regulated firms to hire experts on an ongoing basis versus the capacity for consumers. As the Alternative Technology Association observed in a 2012 submission to the AEMC:

> *The irony of this situation is that consumers actually pay for the advocacy capacity of network businesses, retailers and generators through consumer bills. Effectively, ATA estimate, consumers pay at least one hundred times more for the legal and technical capacity of advocates and peak bodies of the energy networks and market participants than they do for their own consumer advocate representatives.*[12]

However, the concurrent expert evidence session does nothing to test the relevant expertise of the witnesses, and merely perpetuates the issues. While formal procedures have developed for statements by experts about their conduct in the proceedings, as Martire and Edmond note expertise is not required to be demonstrated, for example, expert pathologist evidence is not tested against the historic performance of the expert pathologist. They further note that concurrent evidence sessions 'do not require that participants engage with knowledge or its foundations' consequently 'where procedures have not been appropriately evaluated, legal procedures that do not engage with the fundamentals of expertise would seem to perpetuate traditional means of admitting and evaluating expert opinion.'[13]

Conduct of Concurrent Expert Evidence Sessions

Notwithstanding the fact that concurrent expert evidence sessions do not fully address the issues perceived by judicial officers, they continue to be a popular device in courts and arbitration.

In both these contexts the experts involved are the experts who have provided expert testimony on behalf of a party to the case. There will clearly be some element of 'bias' if only because each party presumably chooses a witness whose evidence supports their claim/case.

To make the concurrent session more efficient it is now standard practice for the experts to meet before the evidence session and establish what elements in their respective reports that they agree on, hence establishing the field for disputation. A joint report may be provided to the court (we will refer only to courts but the same applies to arbiters).

The witnesses will be sworn jointly and will provide oral testimony on their report. They may also be then individually cross examined. Procedures then vary. In some cases only the judge asks questions of the experts, in others counsel for the parties interrogate both, in the more extreme cases the witnesses are allowed to question each other. At the conclusion of their

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[12] Alternative Technology Association 2012. Submission on the AEMC's Draft Determination on the AER's Rule Change Proposal regarding the Economic Regulation of Network Service Providers.
https://www.aemc.gov.au/sites/default/files/content/6565c0de-e2ec-43fb-8422-65f9261a9dbc/Alternative-Technology-Association-received-8-October-2012.PDF
This assessment was based on the then operative funding of $2.2M to the Consumer Advocacy Panel. The threefold increase in budget for Energy Consumers Australia reduces this ratio, but much of the increased funding has gone to an increased scope of work.

[13] Martire and Edmond o*p. cit.* fn7

evidence the witnesses retire and the judge is left with the original statements, the report (if any) on areas of agreement and the transcripts.

The 2018 RoRI Concurrent Expert Evidence Process

It is significant to note that the conduct of the Concurrent Expert Evidence Sessions (the Sessions) for the 2018 RoRI did not follow the process that had been outlined for those sessions in the AER's Rate of Return positions paper of November 2017.[14]

The proposed process was, in part, premised on the idea that expert evidence would already have been tendered by the parties in their responses to the AER's Issues Paper. This resulted in a lack of clarity about what invite experts might say about issues involved.

The AER did proceed, in conjunction with the Consumer Reference Group, and the Energy Network Australia (ENA)-CRG engagement sessions, to develop a set of papers that attempted to identify the matters that were agreed and the matters on which there was disagreement. The priority from the stakeholders' position was established in a documented 'Summary of CRG and ENA current perspectives on elements of the RoR Guideline.'[15]

Prior to each of the two Sessions the AER prepared a series of papers that covered the subject matter that was before the AER. Between the AER papers and CRG/ENA summary a robust set of areas to be explored was developed.

Having called for nomination of experts on the basis of its positions paper, the AER proceeded to change the procedure and introduce a 'facilitator' to the sessions. It was impossible for the experts to meet and reach agreed positions because no expert had given any evidence at this point in the proceedings. The facilitator then proceeded to dispense with the AER's papers and the combined ENA/CRG work and substitute a different list of questions.

Lessons from Experience

The same situation with respect to submissions from experts to the AER Issues Paper is likely to prevail for the 2022 RoRI. Consequently, the essential pre-condition for which concurrent expert evidence sessions have been developed in courts simply will not apply; there are not expert witnesses who have already provided expert statements prior to the 'hearing'.

It is also unrealistic to expect that as a consequence of the concurrent session any experts who disagreed on a substantive point at the start of the session would agree on it after the session. Finally, there are so many points of contention in the process of choosing a method for deriving the Allowed Rate of Return (ARoR) and in the method for the estimation of parameters used in the method that the range of agreement will be far less than the range of disagreement. Consequently, the AER should take control of deciding what the issues are they particularly want to hear evidence on (and in doing so, what should be taken as a given.

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[14] https://www.aer.gov.au/system/files/AER%20-%20Rate%20of%20return%20positions%20paper%20-%2028%20November%202017.docx
[15] https://www.aer.gov.au/system/files/CRG%20issues%20scoping%20document.DOCX

For example, experts could argue for hours about how to choose the gearing ratio and whether it should be based on book or market values. What decision is made on these then flows into other decisions. The AER can and should decide before the sessions the gearing ratio and basis, and allow discussion to proceed on that basis.

The Proposed Instrument Process

The Overall Process

As we understand it the foundational phase was due to conclude with the initial round of working papers were due to be resolved by May 2021. The active process was due to commence in May 2021 and follow the timetable set out in the AER's *Pathway to the 2022 rate of return instrument: Position paper* of May 2020.[16] That timetable and the 'Indicative Timeline' from the current Paper are shown below.

Stage	2018 RoRI Dates	2022 RoRI Plan	Revised timeline
Consultation Paper - Detailed	31 July 2017	May 2021	10 June 2021
Submissions Close			9 July 2021
Stakeholder Forum	18 September 2017	June/July 2021	
Position Paper - Detailed	28 November 2017	October 2021	
2021 Rate of Return Annual data Update		November 2021	
Information Papers (Publish Information Paper)	February 2018	December 2021	December 2021
Experts' Conclave		Early February 2022	February 2022
Concurrent Evidence Sessions	15 March/5 April 2018	February/March 2022	February 2022
Submissions on Information Paper Close			February 2022
Expert joint report	21 April 2018	No longer required	
Draft Instrument	10 July 2018	June 2022	June 2022
Independent Panel Report	September 2018	August 2022	August 2022
Submissions on Draft Instrument Close			September 2022
Final Instrument	December 2018	December 2022	December 2022

This is a somewhat confusing timetable as it seems to insufficiently distinguish between process papers and substantive decision papers. From the timing we assume that the papers highlighted in yellow are process papers, which includes the current Paper.

The timing repeats the timing of the process for the 2018 RoRI which really provided insufficient time for consideration of the Information Paper and then the identification of

[16] https://www.aer.gov.au/system/files/Pathway%20to%202022%20rate%20of%20return%20instrument%20-%20Position%20paper%20-%20May%202020%20-%20Final.pdf

appropriate experts. The Information Paper needs to be released by no later than the middle of November to make the engagement with experts in February effective.

In the current Paper the AER states:

> *The Information Paper, published in December 2020, will identify subject matter where there is a reasonably settled view among stakeholders and those areas where there are still a number of open options and more work is required.*

Based on the experience of 2018 and the experience to date in the 2022 process we suspect the AER is being overly optimistic on the extent to which any agreement can be reached between stakeholders. Secondly, we note that agreement among the stakeholders isn't really a relevant criterion. The only criterion that matters is that the final decision helps achieve the NEO (see below), and that assessment can only be made on the final determination as a whole not on its component parts.

The Concurrent Expert Evidence Sessions

The AER in the Paper identifies that it has decided that the Sessions will assist the Board in its decision-making rather than taking a determinative view. This is consistent both with the AER's legislative obligations and with the practice of sessions as detailed in the Background section of this submission.

However, we disagree that the expert sessions should be an aid to 'the Board exercising its judgement.' As we have outlined in our earlier submission in response to the most recent draft working papers, there is no right scientific answer to the question of what the Allowed Rate of Return should be. The value to the AER of the sessions is to confirm for the AER what the range of potentially reasonable rates should be.

While the AER's task is sometimes seen as balancing the interests of networks and consumers (and this is explicit following *Hope* in US practice), the decision that will contribute to the achievement of the National Electricity Objective (the NEO) is the one that best balances the prices consumers need to pay with the quality of service they can obtain. As we also noted in that submission, the setting of the ARoR is not the only variable in achieving that balance.

The AER is proposing the following arrangements for the Sessions:

1. The AER will call for nomination of experts by stakeholders, and the AER will include those experts that the AER believes will 'best advance our decision-making.'
2. Following the Sessions there will be an opportunity to make submissions, and this is where stakeholders can submit on 'important aspects [they consider] have not been covered in the sessions.'
3. The experts will assemble in an Expert Conclave to 'narrow the topics for consideration, consider how best to follow the agenda and focus discussions.' This will be stakeholders' opportunity to put questions to the experts to debate.
4. There will be a facilitator for the Sessions. They will be run by a Commissioner from the Australian Competition and Consumer Commission (ACCC) with knowledge of rate of return issues.

5. No final expert report will be produced, the Board will rely on the evidence as it is adduced in the Sessions.

The AER is consulting on the following questions:

1. How should the experts be funded?
2. How should the sessions be scheduled?

Ultimately the challenge for the AER is exactly what they propose to gain from the Sessions. If the AER is simply interested in hearing an updated rehash of all the arguments about risk, the CAPM, basis for determining the weighting of equity and debt (gearing), the data sets and procedures for measuring the MRP and Beta, then the outlined procedure will certainly deliver.

If, however, the AER is more explicitly interested in the question of how wide the potential area for discretion on the ARoR is, and what the consequences in terms of balancing the outcomes on price and quality of service then the approach to the Sessions needs to be refocussed on the decision as a whole, rather than the components of the decision.

The AER's observations that there is a significant imbalance in the resources available to different stakeholders is valid, and the decision that the engagement of experts be funded by the AER is supported. If the AER is funding the experts, then we believe it is appropriate that the AER directly engage the experts.

We have some concerns, however, that ACCC processes may then require the AER to undertake a tender process for experts rather than be able to appoint the experts nominated by stakeholders. Either process is still likely to draw the experts from the very narrow gene pool of academics and consultants who are interested in the work and don't have anything better to do with their time.[17] This is the ongoing limitation of expert evidence noted by Justices McClellan and Rares above that we do not think is adequately resolved by the device of Concurrent Expert Evidence Sessions if they don't result in an expansion in the pool of available experts.

We are concerned that the AER is repeating the facilitator process, albeit using an ACCC Commissioner instead of a consultant. However, this is a deviation from other models of concurrent evidence sessions where the experts are quizzed by either the judge/arbitrator or by counsel for the parties. We submit that it would be preferable for the sessions to be run by one of the AER Board.

We submit that the parties and history of Rate of Return processes mean the AER cannot easily avoid debate on the components of the decision. We think the purpose of the sessions needs to focus not so much on which of the competing methodologies is 'right' but what the consequence of each choice is on the decision as a whole. In this format the four two and a half sessions over two days seems reasonable.

[17] Any academic who is genuinely at the forefront of research questions on issues of finance is far more likely to want to spend their time undertaking new finance research, not simply trawling over old ground on which there has been no original thought for twenty years.

However, we submit that the AER should schedule an additional three hour session at which experts are quizzed on the implications of possible decisions as a whole within the ranges identified by application of the methods and procedures discussed at the earlier sessions.

Finally, we agree with the AER's decision not to seek a summary report from the expert sessions. However, we equally find the prospect of participants responding to the expert sessions in their submissions problematic without any guidance on what the AER itself has 'heard.' We therefore propose that before submissions close the AER should issue a form of 'directions paper' or 'preliminary observations paper' that summarises what the AER understands to have occurred.

The Independent Panel

We believe the Independent Panel was a highly effective process for the 2018 RoRI. The Panel provided clear advice on where it thought aspects of the draft determination were deficient in terms of the evidence provided by the AER for the decision. In almost all cases the issue was well resolved by the AER providing further explanation or, in one case, revising calculations.

We note that some stakeholders thought there were aspects of the draft that they would like to have drawn the attention of the Independent Panel to. We note the AER has decided that there will be no communication with the Panel other than the Draft Determination and response to questions. We encourage the AER to reconsider this point, and instead allow any stakeholder once the Draft Determination is published to specify in no more than two pages any aspect of the Draft were they would like the Independent Panel to pay particular attention to the reasoning.

The AER is consulting on the following questions:

1. How many members should comprise the Independent Panel?
2. How should members be selected?

The size and diversity of the panel for the 2018 RoRI provided stakeholders with confidence that all perspectives were well represented. We see no benefit in changing the number of members.

Similarly, the approach of calling for nominations helped significantly in ensuring this diversity. If the AER wanted to strengthen this aspect the final stage of selection, before recommendation to the AER Board, could be a three member selection committee comprising the AER Board member in charge of the process, and a nominee from each of Energy Networks Australia and the Consumer Reference Group. (We suggest the same selection panel could be used in selecting the experts for the Sessions.)

Conclusion

The Concurrent Expert Evidence Sessions and the Independent Panel are important aspects in providing confidence to stakeholders in the AER's determination of the Allowed Rate of Return. They do not, however, replace the judgement required of the AER in reaching its decision in making the RoRI.

The judgement involved is not a judgement between competing theories (or interpretation of theories) in finance. It is the judgement about what ARoR reaches the appropriate balance between prices and the quality of service delivered by networks. In reaching this decision the AER also needs to recognise the impact of the incentive schemes.

We recommend the AER includes an extra session for the experts that focuses on the decision as a whole, and that the AER fund the experts selected. We encourage the AER to reconsider the use of an ACCC Commissioner to conduct the sessions and suggest that an AER Board member should perform that role.

We recommend the same size Independent Panel as used in 2018 (five members) and suggest that a three person selection committee drawn from the AER, ENA and CRG should make final recommendations to the AER Board.

Overall, the Independent Panel is an effective mechanism, while the Concurrent Expert Evidence Sessions are of little value and do not in this context deliver the benefits expected of them by judges.