

Economic Experts: how necessary are they?

ACCC 2009 Regulatory Conference

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What are Australian Regulatory processes?

- Regulatory processes arise under:
 - NEL and NER
 - NGL and NGR
 - Part XIC of the Trade Practices Act (TPA) (telecommunications specific access regime)
 - Part IIIA of the TPA (general access regime)

Australia regulatory processes



- In terms of forum, regulatory processes are:
 - Processes before a regulator (ACCC, AER & NCC/Minister)
 - Merits review proceedings in the Australian Competition Tribunal (Tribunal)
 - Judicial review proceedings in the Federal Court

Merits review in the Competition Tribunal



- Merits review under the NEL/NER and Part XIC is subject to an evidentiary limit.
- Only material, including expert reports, that were provided to or otherwise examined by the ACCC/AER during the original decision making process can be taken into account by the Competition Tribunal.
- Therefore, experts role has been limited to the first stage of a regulatory process that permits merits review.

Judicial Review of Regulatory Decisions



- Decisions of ACCC, AER, NCC/Minister and the Competition Tribunal are subject to Judicial Review in the Federal Court.
- Judicial Review essentially is limited to decisions that were not made in accordance with law, as distinct from a review of merits of the decision.
- However, unlike in merits review subject to an evidentiary limit, expert economic evidence may be introduced for example to support a claim the decision was an improper exercise of power as the regulator failed to take a relevant consideration into account.

What issues are the experts addressing?



- explaining economic concepts as they appear in the legislation
- applying economic theory to the facts of the case
- evaluating particular propositions by reference to economic/econometric models
- assessing input parameters into cost estimates
- discussing technical matters in respect of the infrastructure or service the subject of the regulatory process

Role of experts in *what* to regulate



- In deciding whether or not to regulate (eg, declaration under Part IIIA and Part XIC of the TPA), the predominant issues addressed by expert economic evidence are:
 - the effect of regulation on competition; and
 - the question of whether the relevant infrastructure or service has bottleneck or natural monopoly characteristics.
- The role of the expert in decisions about *what* to regulate is not unlike that of an expert in Part IV matters.

Role of experts in *how* to regulate



- In deciding how to regulate on the other hand, modelling and technical evidence (requiring expertise beyond that of a traditional industrial organisation economist) appears to be more prevalent.
- Modelling and technical evidence can be used in this class of regulatory proceedings, for example, to estimate costs, forecast demand, estimate capacity and to calculate WACC parameters.

Use of experts in Judicial Review Proceedings



- Expert evidence in judicial review proceedings is subject to the 'relevance test' in the *Evidence Act 1995 (Cth)*
- Until relatively recently, the 'threshold test of relevance' has operated to confine the use of expert evidence that was not before the regulator in judicial review proceedings to:
 - evidence as to the proper construction of words used in the relevant statute, in particular where those words have a specialised or technical economic meaning; and
 - establish that the decision under review was unreasonable in the *Wednesbury* sense - that is, the decision under review was so unreasonable that no reasonable decision-maker could have made such a decision

Judicial Review - Admission of expert evidence on words with economic/technical meaning



- *In Telstra Corporation v ACCC* (2008) ATPR 42-259, Telstra sought judicial review of the ACCC's determination of an arbitral dispute in respect of the ULLS between Optus and Telstra under Part XIC of the TPA.
- The evidence admitted included evidence in relation to 'how concepts such as a soft dial tone, a communications wire and other network paths operated.'
- Justice Rares conclusion appears premised on the principle that expert evidence, including as to the meaning of *economic or technical terms used other than in the relevant statute*, is admissible to impugn a regulator's decision on the ground of *Wednesbury* unreasonableness

Judicial Review – Admission of expert evidence to support *Wednesbury* unreasonableness



- In *Telstra v. ACCC* [2009] FCA 757, the parties submitted to the Court expert economic evidence relating to the WACC parameter adopted by the ACCC in arbitrating a number of telecommunications access disputes (relating to access to Telstra line sharing service (**LSS**)) under Part XIC of the TPA.
- In alleging *Wednesbury* unreasonableness on the part of the ACCC in rejecting Telstra's arguments that there was 'welfare asymmetry' in relation to underestimating and overestimating the WACC parameter, Telstra has sought to rely on expert economic evidence not before the regulator.
- In response, the access seeker a party to the proceedings submitted expert economic evidence that was not before the ACCC to support its case that the decision by the ACCC was not *Wednesbury* unreasonable.

Merits review in the Tribunal – a sea change?



- The Tribunal is in transition and, with it, the role of expert economic evidence.
- The Tribunal is an administrative decision maker. It does not exercise judicial power and is not bound by the rules of evidence.
- Perhaps less formality and adherence to Federal Court procedure? Eg. Expert round table conferences

Historic Tribunal approach - example 1



- The Tribunal in *Telstra Corporation Ltd (2006)* ATPR 42–121 assessed the expert evidence as to whether the levelisation period used by Telstra in determining the LSS price specified in the undertaking satisfied the 'reasonableness' criteria in ss152AH and 152AB of the TPA, in doing so the Tribunal:
 - scrutinised the expert report provided by Telstra's expert;
 - accepted certain of the contentions of the non-Telstra parties; and
 - concluded that while the expert report was 'presented ... as a judgment that had balanced the relevant matters that need to be considered, [the expert] had only considered a subset of those matters to which the statute demanded attention be paid. In particular, [the expert] did not consider the long-term interests of end-users'

Historic Tribunal approach example 2



- In *Telstra Corporation Ltd (No 3) (2007)* ATPR 42-160 the Tribunal affirmed the ACCC's decision to reject Telstra's ordinary access undertaking for the unconditioned local loop service (**ULLS**) and in doing so the Tribunal weighed various expert reports in respect of reasonableness of the cost estimates generated by Telstra's 'PIE II' model (amongst other matters). The Tribunal determined the extent of reliance that should be placed on the reports on the following bases:
 - the reports did not, in fact, address that proposition;
 - the expert was instructed to proceed on the basis of the proposition in issue; or
 - the facts or assumptions on which the expert opinion was based were not established by the party seeking to rely on the proposition

The new Tribunal approach to expert economic evidence



- Application by Chime Communications Pty Ltd (No 2) [2009] ACompT 2 at [8] –[9]

'[T]he function of a specialist tribunal is different to that of a judge. Judges must decide cases based on the facts that have been tendered in evidence. The judge is an expert in the law and will rely on that expertise in deciding a case. In addition, a judge may use extrinsic material as a source of ideas...

The Tribunal, however, is better placed than a judge. It has no need to go to external material to inform itself of, for example, principles of industrial organisation, although those principles may go to the very heart of an issue before it. The reason the Tribunal has no need to look to extrinsic material is that some of its members were appointed because they possess knowledge of those principles.'

The sea change



- In *Chime No 2* the Tribunal undertook its own extensive “literature review” of all the competing theories relevant to:
 - The “promotion of competition” element of the LTIE test
 - The various models of competition and in particular “contestability theory”
 - The principles and approach to determining competitiveness.
- The Tribunal rejected the expert report relied upon by Telstra primarily because it was formulated on the basis of contestability theory, a theory which, based on its specialist knowledge and expertise, the Tribunal had rejected in forming an independent opinion on the economic principles and theory to the apply to the proceedings.

Where to from here?



- How will the Tribunal balance the 'new approach' of the Tribunal itself acting as an 'expert' in economics against the procedural fairness entitlements of the parties?
- What will the Tribunal's approach be to expert opinion on matters other than industrial organisation economics such as the estimate of WACC parameter values, demand forecasts, depreciation methodologies and network costing models?

Some implications of Tribunal's new approach for experts?



- No longer suffice to merely address the expert economic evidence presented by the other parties?
- Anticipate views of the Tribunal members and address these views, to the extent known.
- Review and address all relevant economic theories?
- Brief economists from differing schools of economic thought (rather than a single expert)?

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