MCC's submission on the CMA's draft water rules

It is our pleasure to introduce MCC Economics and Finance (MCC). We are an international advisory firm specialising in economic regulatory frameworks. Our experience spans multiple jurisdictions and sectors.

We have extensive experience working on regulatory determinations and their review. We have worked for regulators, consumers and regulated utilities. Given our interest and experience in this area, we offer a few suggestions on the CMA's draft rules of procedure and guidance for water redetermination references (draft rules).

1. It is a good idea to have specific rules for water redeterminations

Regulatory determinations have unique characteristics which distinguish them from more generic processes. Most important is the nature of the parties to the decision. In many processes, there are two well-resourced and motivated parties who are able to bring their interests forward to be considered in the decision-making process. That is not the case in water and other utility determinations. Consumers typically have less ability to participate because they are widely dispersed and poorly resourced, motivated and informed. Yet it is consumers who ultimately bear the consequences of the decision. The rules can assist in redressing this imbalance by explicitly recognising the interests of consumers.

2. There are important lessons to be learned from Australia

While we recognise there are important distinctions between merits review and redetermination processes, they share commonalities which mean the CMA can learn from the experience of limited merits review in Australia.

In particular, we think it is important for the CMA to recognise that it is hard for consumer interests to be effectively considered in regulatory determination processes. This difficulty is

magnified in merits review and redetermination processes. As such, it is important for the CMA to pay special attention to the interests of consumers in the redetermination process.

In Australia, merits review of gas and electricity network determinations was introduced in 2008. The regime:

> *was first reviewed in 2012 by an independent panel led by Professor George Yarrow. Amendments were made in 2013 with the goal of improving timeliness, reducing costs, increasing consumer participation, and refocussing the process on the long-term interests of consumers.*
>
> *Despite these attempted reforms, energy networks were still routinely seeking reviews of the regulators' decisions, essentially using the Australian Competition Tribunal as a second regulator.*
>
> *In response the Council of Australian Governments (COAG) Energy Council reviewed the LMR (Limited Merits Review) regime again in 2016. The review found that the 2013 amendments to the regime had largely failed, including that LMR: remained routine; had significant costs to all participants; presented barriers to meaningful consumer participation; led to significant regulatory and price uncertainty; and was failing to demonstrate outcomes that were in the long-term interests of consumers.*
>
> *The COAG Energy Council determined that the LMR regime was still failing to meet its policy intent with the consequence of higher prices for consumers.*
>
> *In the face of escalating energy prices, the government is taking action to stop energy networks using the LMR to extract monopoly rents from consumers. That is why the government announced on 20 June 2017 that it would divest the Australian Competition Tribunal of its LMR function—effectively abolishing the regime.*[1]

Since the removal of limited merits review in Australia, there has been a fundamental transformation of the regulatory determination process. Consumers are now able to effectively participate and influence regulatory decisions. In its most recent decisions, the Australian Energy Regulator noted:

[1] Commonwealth of Australia, Parliamentary Debates, HOUSE OF REPRESENTATIVES BILLS, Competition and Consumer Amendment (Abolition of Limited Merits Review) Bill 2017, Second Reading SPEECH, Thursday, 10 August 2017, Mr. FRYDENBERG (Kooyong—Minister for the Environment and Energy) (09:32). See also: Standing Council on Energy and Resources, Regulation Impact Statement, Limited Merits Review of Decision Making in the Electricity and Gas Regulatory Frameworks, Decision Paper, 6 June 2013, page i. https://oia.pmc.gov.au/sites/default/files/posts/2013/08/03-RIS-DRET-LMR-Decision-RIS-20130808.pdf

> *… we have seen a strong commitment from all 2024–29 businesses to engage with customers and have their preferences considered and reflected in their revenue proposals.*
>
> *Ausgrid has continued its extensive engagement program since the draft decision, successfully drawing out customer priorities and maintaining a strong partnership with the Reset Customer Panel (RCP). We acknowledged in our draft decision that Ausgrid has stepped-up its engagement with customers and stakeholders. We have continued to see Ausgrid develop its consumer-centric culture throughout this process.*[2]

We see considerable risk that the CMA will face a large and increasing quantity of referrals which will ultimately lead to community dissatisfaction with the process. This was the case in Australia where the regulatory process was subverted and consumers were disenfranchised. It is critical that the regulatory process embodies a consumer-centric culture. The CMA has a central role here. It must not become a one-way bet for regulated entities. The redetermination process must place consumer outcomes at the centre and give consumers a genuine voice and influence in the outcome.

3. The proposed objective in clause 4.1 is mis-directed

The opening words of clause 4.1 are:

> *The overriding objective of these Rules is to enable the CMA to dispose of redetermination references …*

This construction has two failings. First, it implies that the rules are established for the benefit and convenience of the CMA. Second, and most importantly, the proposed objective is not grounded in the objectives of the authorising legislation including its focus on furthering the consumer objective.

We think a better statement of the objective would be:

[2] Australian Energy Regulator, April 2014, Final Decision, Ausgrid Electricity Distribution Determination 2024 to 2029 (1 July 2024 to 30 June 2029), Overview, page x. https://www.aer.gov.au/documents/aer-final-decision-overview-ausgrid-2024-29-distribution-revenue-proposal-april-2024

The overriding objective of these Rules is to promote the objectives of the authorising legislation by setting out rules that enable a process that is fair, efficient and at a proportionate cost within the time periods prescribed in the Act.

4. Special provisions are needed to ensure consumer interests are heard and considered

In the draft rules, the term "parties" appears 29 times. There is a clear expectation that the CMA will be informed by a balanced range of submissions, but this is unlikely to be the case. While the Consumer Council for Water is established to support consumer interests, its funding is limited and it is engaged across a range of activities other than the regulatory determination process. To determine a fair and balanced outcome, the CMA will need to make special provisions for consumer views and interests to be considered and influence the outcome.

This will not be easy.

We suggest that the CMA consider including the following provisions:

- The regulated entity and regulator are required to submit statements outlining the consumer engagement they undertook during the process and the way the views of consumers have influenced their proposal and decision. These statements should be endorsed by consumers prior to submission to the CMA.
- The CMA should invite and hear directly from consumers who have participated in the original process. Recognising that consumers may not have the same level of sophistication and background as the regulated entity and regulator, the CMA should undertake a process that is informal and welcoming.
- The CMA should indicate that it will consider the reasonableness of its decision as a whole including its ultimate impact on the consumer interest. It is important to avoid cherry-picking where issues are considered in isolation. There should be a reasonable prospect that the CMA's decision will result in a worse outcome for the regulated entity.

- The CMA should recognise that regulatory determinations involve the exercise of regulatory judgement. There is no single correct answer and reasonable people can reach different conclusions. The CMA is at a disadvantage because it does not have the benefit of time and engagement with the stakeholders of the original decision maker. The CMA should therefore signal a high hurdle before it materially intervenes, and it should clearly demonstrate how any intervention is in the interests of the community. The CMA certainly should not materially intervene on the basis that it slightly prefers a beneficial outcome for water companies.

- Social licence to operate has become a major feature of the landscape for all organisations. The CMA should be conscious of discharging its social licence obligations when exercising its role in redeterminations.

5. Potential cost orders are a barrier to consumer participation

With limited financial resources, consumers are less able to risk an adverse cost order. The CMA could improve the balance in the redetermination process by signalling a high hurdle before cost orders are made against consumers.

6. Transparency of process supports good outcomes

Paragraph 2.16 of the consultation document states "The Group will not normally conduct hearings in public …". This approach is inconsistent with good governance principles which are supported by a transparent process. We suggest that the presumption should be that hearings will be conducted in public unless there are good reasons not to. Public hearings can be readily accommodated using modern communications technology.

7. Conclusion

We welcome the proposed rules for water redeterminations and the enhanced outcomes they offer for consumers. We would be pleased to assist further.