IN THE MATTER OF THE DRAFT NATIONAL ELECTRICITY AMENDMENT (ECONOMIC REGULATION OF TRANSMISSION SERVICES) RULE 2006

MEMORANDUM OF ADVICE

1. Our advice is sought on five questions arising from the initial Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 (**Draft Revenue Rules**).

2. The questions on which we are asked to advise, together with our short answers, are as follows:

   2.1. Do the Draft Revenue Rules impose a "burden of proof" (in the sense of a requirement to advance evidence) in respect of the determination of forecast operating expenditure (**OPEX**) and capital expenditure (**CAPEX**), and if so, what is the nature of the burden, and who bears it?

   Answer

   Under the Draft Revenue Rules as currently drafted, certain practical consequences flow from the submission of a revenue proposal, by a transmission network service provider (**TNSP**), to the Australian Energy Regulator (**AER**) including in respect of forecast OPEX and CAPEX.

The structure of sub-clause 6A.6.6(b) is that of a duty which is subject to a precondition. That is, if:

(a) the forecast OPEX is for expenditure properly allocated in accordance with (b)(1); and

(b) the forecasts and information provided comply with the submission guidelines in accordance with (b)(3), (criteria expressed in wholly objective terms); and

(c) the total of forecast operating expenditure is determined by the AER to be a reasonable estimate in accordance with (b)(2),

then the AER must accept the forecast operating expenditure.

Accordingly, it initially lies with a TNSP to put before the AER material which meets the requirements stated at (a) and (b) above, and which is capable of supporting a determination of the kind referred to in (c).

In the event that the AER determines that a TNSP's estimate is not a reasonable estimate, the AER:

a may nevertheless accept the proposal: clause 6A.14.3(a); and

b should it refuse to approve an amount or value, it must determine a substitute amount for forecast OPEX and CAPEX: clause 6A.13.2(b)(3)).

2.2. What are the circumstances in which the AER is obliged to accept the TNSP's proposed forecast OPEX and CAPEX in its determination of the allowed forecast amounts?

Answer

The AER is obliged to accept the TNSP's proposed forecast OPEX and CAPEX where it *determines* the forecast expenditures to be reasonable taking into account the matters set out, respectively, in clause 6A.6.6(b) and 6A.6.7(b); or where it *is satisfied* under clause 6A.14.3(b)(5) and (6) that the forecast expenditures are reasonable, taking into account the matters set out, respectively, in clauses 6A.6.6(b) and 6A.6.7(b).

2.3. In what circumstances may the AER choose not to adopt the TNSP's proposed forecast OPEX and CAPEX in its determination of the allowed forecast amounts, and in particular, must the AER prove or establish that the TNSP's proposed forecast is "unreasonable" before it can make its own determination of the allowed forecast amounts?

Answer

Clause 6A.6.6(b)(2) confers on the AER the function of determining whether forecast OPEX is "a reasonable estimate" of the required operating expenditure, taking into account the matters specified. While "a reasonable estimate" is a matter on which minds may differ, the sub-clause does not require the AER to determine a reasonable range, and then ascertain whether the forecast operating

expenditure falls within that range. Nor does it call for a determination as to whether forecast operating expenditure "is not unreasonable". The clause uses the phrase "a reasonable estimate", which is the language to be interpreted and applied; it is an invitation to error to substitute other language for that of the rule. In this statutory context, a forecast OPEX or CAPEX could be determined not to be a reasonable estimate, without the AER having to affirmatively determine that it is "unreasonable".

It appears to be the intention of the Draft Revenue Rules that, where the AER refuses to approve an amount referred to in clause 6A.14.1(1) for the reason, or for a reason which includes the reason that, the AER is not satisfied that the proposed OPEX or CAPEX is reasonably required, the AER must include within its final decision a substitute value for the forecast OPEX or CAPEX which it determines to be reasonably required (clause 6A.13.2(b)(3) and (4)).

2.4. Under the Rule (as amended in the manner proposed by Counsel) does any presumption in favour of the TNSP's proposal for forecast expenditure arise, and, if so, in what circumstances?

Answer

To speak of a "presumption in favour" of a TNSP's proposal implies an evidential notion of presumptive weight arising from the submission by a TNSP of a proposal to the AER. The answers to questions one and two above are that the relevant issue is one not of evidential weight as such, but of an initial evidential standard which must be met by a TNSP in submitting a proposal to the AER,

and which, if the AER determines the estimate to be reasonable (after taking account the mandatory matters) leads to an obligation upon the AER to accept the forecast.

2.5. If the AER is satisfied that a TNSP's proposal for forecast expenditure satisfies the requirements of the Rules, does it have any residual discretion to reject the proposal including because the AER considers that an alternative figure may "better" satisfy the criteria?

Answer

No. The Draft Revenue Rules as currently drafted impose a mandatory but conditional obligation upon the AER in respect of proposals of forecast OPEX and CAPEX submitted by a TNSP. Once the AER determines that the proposal is a reasonable estimate, it is required to accept the proposal. The test is essentially binary – the proposal is either reasonable or it is not reasonable (although several proposals may fall within each category). Accordingly, the AER does not enjoy scalar possibilities in its decision-making. For example, the AER could not determine that a proposal, though reasonable, is sub-optimal, and therefore should be supplanted by a "better" reasonable proposal.

3. We are also asked to advise generally as to the implications of using different forms of statutory language and structures in operative regulatory decision-making provisions. In particular you have asked us to discuss:

3.1. the terms "best estimate", "reasonable estimate" and any intermediate terms connoting a "realistic" estimate, in relation to the threshold that must be satisfied by an applicant submitting a proposal to a regulatory decision-maker; and

3.2. different statutory structures which confer a power or impose a duty upon a regulatory decision-maker, for example:

a an affirmative mandatory conditional structure: "X must accept Φ if Y" (as found in current clauses 6A.6.6 and 6A.6.7 of the Draft Revenue Rules); and

b a negative mandatory conditional structure: "X must not accept Φ unless Y" (as found in section 152BV(2)(b) of the *Trade Practices Act* (1974) (Cth)).

Our advice on these issues is set out below.

Statutory Framework

4. For the purposes of this advice, the pivotal notions within Chapter 6A are:

4.1. revenue proposals submitted to the AER by a TNSP;

4.2. prescribed transmission services provided by a TNSP;

4.3. transmission determinations (and specifically, revenue cap determinations) made by the AER;

4.4. forecast OPEX for each regulatory year of a regulatory control period;

4.5. forecast CAPEX for each regulatory year of a regulatory control period; and

4.6. draft and final decisions of the AER.

5. In this section, we outline the architecture of Chapter 6A by reference to these concepts.

6. Rule 6A.2 provides that the AER must make transmission determinations,[1] including, relevantly, revenue cap determinations.[2]

7. Clause 6A.2.1(1) imposes an obligation upon the AER, relevantly, to make transmission determinations for TNSPs regarding prescribed transmission services.[3]

8. Clause 6A.2.2 relevantly provides that the contents of a transmission determination for a TNSP include a revenue cap determination for the provider, in respect of the provision by the provider of prescribed transmission services.

9. Clause 6.4.1(a) provides that the process for making a revenue cap determination for a transmission network service provider is contained in Part E, and involves the submission to the AER of a revenue proposal[4] by the provider. Clause 6.4.1(b) provides that a revenue proposal must

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[1] Defined in the Glossary as having the meaning in the National Electricity Law, and including a determination by the AER as described in rule 6A.2

[2] Defined in the Glossary as meaning, a determination referred to in clause 6A.2.2(1) and rule 6.4 as substituted (if at all) pursuant to clause 6A.7.1 or rule 6A.15 or as amended pursuant to clause 6A.8.2

[3] Defined in the Glossary at Chapter 10, and set out in the draft rule in the third set of definitional amendments (starting on page 13 under item [3]) and located at page 16 of Schedule 3 of the draft Revenue Rule.

[4] Defined in the Glossary as meaning, for a TNSP, a proposal submitted or resubmitted by the TNSP to the AER pursuant to clause 6A.10.1(a), clause 6A.11(2) or clause 6A.12.3(a) (as the context requires)

comply with the requirements of Chapter 6A, and in particular must be prepared using the post-tax revenue model referred to in rule 6A.5, and comply with the requirements of the submission guidelines referred to in clause 6A.17.2 (and set out at Schedule 6A).

10. Clause 6.4.2 prescribes the contents of a revenue cap determination for a TNSP for a regulatory control period. The matters which must be addressed include:

    10.1. the amount of the estimated total revenue cap for the regulatory control period or the method of calculating that amount;

    10.2. the annual building block revenue requirement for each regulatory year of the regulatory control period; and

    10.3. the amount of the maximum allowed revenue[5] for each regulatory year.

11. Clause 6A.5.4 sets out the building blocks approach in relation to the annual building block revenue requirement[6] for a TNSP. One of the building blocks is the forecast OPEX accepted or determined by the AER for that year (clause 6A.5.4(a)(6), cross-referenced to clause 6A.5.4(b)(6), which provides that the forecast OPEX is accepted or determined by the AER in accordance with clause 6A.6.6(b) *or* clause 6A.13.2(b)(3)). Forecast CAPEX lies outside the building block methodology.

12. Rule 6A.6 provides for the matters relevant to the making of a revenue cap determination.

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[5] As defined in the Glossary
[6] As defined in the Glossary

13. Clause 6A.6.6 provides for the forecast OPEX proposed by a TNSP, and the matters relevant to the AER in accepting that forecast as reasonable.

14. Relevantly clause 6A.6.6(a) provides that a revenue proposal must include a forecast OPEX for each regulatory year of the relevant regulatory control period which the TNSP considers is reasonably required in order to:

14.1. efficiently meet the expected demand for prescribed transmission services over that period;

14.2. comply with all applicable regulatory obligations associated with the provision of prescribed transmission services;

14.3. maintain the quality, reliability and security of supply of prescribed transmission services; or

14.4. maintain the reliability, safety and security of the transmission system through the supply of prescribed transmission services.

15. Clause 6A.6.6(b) provides that the AER must accept the forecast OPEX for each regulatory year as provided under paragraph 6A.6.6(a), if:

15.1. the forecast OPEX is for expenditure that is properly allocated to prescribed transmission services in accordance with the principles and policies set out in the Cost Allocation Methodology for the TNSP;

15.2. the total of the forecast OPEX for the regulatory control period as provided under paragraph (a) is determined by the AER to be a reasonable estimate of the TNSP's required operating expenditure for the regulatory control period, taking into account:

(i) the information included in or accompanying the *Revenue Proposal* or revised proposal;

(ii) the need to comply with all applicable *regulatory obligations* associated with the provision of *prescribed transmission services*;

(iii) submissions received in the course of consulting on the *Revenue Proposal;*

(iv) such analysis as is undertaken by or for the *AER* and is *published* prior to or as part of the draft decision of the *AER* on the *Revenue Proposal* under rule 6A.12 or the final decision of the *AER* on the *Revenue Proposal* under rule 6A.13 (as the case may be);

(v) the actual and expected operating expenditure of the provider during any preceding *regulatory control periods*;

(vi) the extent to which the forecast operating expenditure of the provider is referable to arrangements with a person other than the provider, that might not be on arm's length terms;

(vii) reasonable estimates of the benchmark operating expenditure that would be incurred by an efficient *Transmission Network Service Provider* over the *regulatory control period*;

(viii) the reasonableness of the demand forecasts on which the forecast operating expenditure is based;

(ix) the relative prices of operating and capital inputs;

(x) efficiency of substitution possibilities between operating and capital expenditure;

(xi) whether the total labour costs included in the capital and operating expenditure forecasts for the *regulatory control period* are consistent with the incentives provided by the *service target performance incentive scheme* that is to apply to the provider in respect of the *regulatory control period*; and

(xii) whether the forecast operating expenditure includes amounts relating to a project that should more appropriately be included as a *contingent project* under clause 6A.8.1(b); and

15.3. the operating expenditure forecasts and the information provided in relation to those forecasts, comply with the requirements of the *submission guidelines* made under clause 6A 10.2.

16. Clause 6A.6.7 provides for the forecast CAPEX proposed by a TNSP, and the matters relevant to the AER in accepting that forecast as a reasonable estimate. Clause 6A.6.7 includes provision for inclusion of forecast CAPEX for contingent projects in certain circumstances.

17. Clause 6A.6.7(a) replicates, in respect of forecast CAPEX, clause 6A.6.6(a). Similarly, clause 6A.6.7(b) replicates clause 6A.6.6(b) save for the inclusion of an additional sub-paragraph (2) requiring that,

> subject to subparagraph (3):
>
> (i) the forecast capital expenditure is identified in the *Revenue Proposal* as a *reliability augmentation;*
>
> (ii) the forecast capital expenditure is necessary for the *Transmission Network Service Provider* to comply with all applicable *regulatory obligations* associated with the provision of *prescribed transmission services*; or
>
> (iii) the forecast capital expenditure has satisfied the *regulatory test;*

18. Rule 6A.10 provides, relevantly, for revenue proposals. Clause 6A.10.1 governs the procedure relating to the submission of a revenue proposal by a TNSP; while clause 6A.10.2 makes provision in respect of the submissions guidelines to be issued by the AER.

19. Rule 6A.13 provides for the making of a final decision by the AER in relation to a Revenue Proposal or a proposed negotiating framework.

20. Clause 6A.13.1 relevantly provides that the AER must make a final decision taking into consideration any submissions on the draft decision or on the revised Revenue Proposal or on the revised proposed negotiating framework.

21. Clause 6A.13.2, relevantly, sets out what must be included in a final decision if the AER decides to refuse certain amounts or values (such as the total revenue cap or the maximum allowed revenue).

22. Clause 6A.14.1 identifies, by reference to content, the decisions which constitute a draft decision of the AER under rule 6A.12 or a final decision of the AER under rule 6A.13.

23. Clause 6A.14.3 makes provision for the circumstances in which the AER must approve certain matters in making a draft or final decision. Relevantly, clause 6A.14.3(a) provides that if the AER is not required to approve a matter in accordance with the clause, it may, but is not required to, refuse to approve that matter. Further, clause 6A.14.3(b) provides that the AER must approve, relevantly, the total revenue cap for a TNSP for a regulatory control period, as set out in the revenue proposal is the AER is satisfied that certain requirements have been satisfied.

24. Rule 6A.19 makes provision for the allocation of costs as between different categories of transmission services.

First Question: Burden of Proof

25. The first question upon which we have been asked to advise is, do the Draft Revenue Rules impose a "burden of proof" (in the sense of a requirement to advance evidence) in respect of the determination of forecast OPEX and CAPEX, and if so, what is the nature of the burden and who bears it?

26. It is settled, at least at the level of the Full Federal Court, that the technical rules relating to onus of proof developed by the courts do not apply to

administrative decision-making: *McDonald v Director-General of Social Security* (1984) 1 FCR 354 at 356.9, 366.8, 369. However, as the Full Court observed in relation to the Administrative Appeals Tribunal in *East v Repatriation Commission* (1987) 16 FCR 517 at 534, after referring with approval to the principle in *McDonald*:

> having said that, the practical situation remains that it will often be in the interests of a party to proceedings before the Tribunal to adduce particular evidence; the reason being that, in the absence of that evidence, the Tribunal will not be free to make the decision sought by that party.

27. Wilcox J put the matter this way in *QAAH v Minister for Immigration and Multicultural and Indigenous Affairs* (2005) 145 FCR 363 at [69],[7] a decision concerning the cessation clause in the Refugees Convention:

> I accept that, in a technical sense, no burden of proof rests on any party in relation to review of an administrative decision: see *McDonald v Director-General of Social Security* (1984) 1 FCR 354; see also Crock, Mary *Immigration and Refugee Law in Australia* (The Federation Press, Sydney, 1998) pp 138, 262, and the authorities there cited. However, it matters to the parties which one of them fails if the evidence is inconclusive, as may well happen when (as here) the critical question concerns conditions in a remote part of a foreign country.

28. The correctness of this passage was called into question in argument before the Full Federal Court in *NBGM v Minister for Immigration and Multicultural and Indigenous Affairs* [2006] FCAFC 60, a decision that addressed the same issues to which Wilcox J was referring in QAAH. Allsop J, with whom Black CJ, Marshall and Mansfield JJ relevantly agreed, eschewed reliance upon notions of onus or burden of proof,

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[7] An appeal from this decision to the High Court has been argued and is reserved.

focussing instead upon "the process of interpreting or construing the language used": at [183].

29. In a related context, that of consideration of the "balance of probabilities" standard in administrative decision-making, the High Court has emphasised the difference between curial and administrative decision-making, pointing out that, in administrative decision-making, a whole range of possible approaches may be available without falling into legal error: *Minister for Immigration and Ethnic Affairs v Wu Shan Liang* (1996) 185 CLR 259 at 282.5.

30. These cases emphasise that notions of onus or burden of proof in administrative decision-making are not apposite. The task for a decision-maker is to construe and apply the terminology of the applicable clause.

31. It is to those matters that we now turn.

Second to Fourth questions: Forecast operating expenditure

32. While the concept of forecast operating expenditure is not in terms defined in clause 6A.6.6, it is the forecast made by the TNSP, under sub-clause (a), of the expenditure which the TNSP "considers is reasonably required in order to" meet the four stated objectives in sub-clause (a).[8]

[8] We note that the four elements of sub-clause 6A.6.6 (a) are expressed in the alternative. Notwithstanding that sub-clause (a) refers to the forecast OPEX reasonably required for each regulatory year, while sub-clause 6A.6.6 (b)(2) refers to a reasonable estimate of required OPEX for a regulatory control period (being 5 years), we consider that clause 6A.6.6 should be phrased as referring to the amount required to meet all four objectives, and suggest that the use of "and" rather than "or" after sub-clause (a)(3) would better reflect that intention. While we understand that forecast OPEX for any single year may not (for any number of reasons including factual contingencies) address each of the four matters enumerated at sub-clause (a), the forecast OPEX for the regulatory control period inevitably would address all four matters. Accordingly, any annual forecast for years in which one of the matters does not arise, may be better expressed as a forecast for that year of zero, while the overall forecast for the regulatory control period could be expressed as having a

While the phrase "required operating expenditure" is not defined either, where that phrase is used in 6A.6.6(b)(2), it is apparently intended to be a reference to the expenditure "reasonably required in order to" meet those four objectives, subject to the matters raised below.

33. The structure of the operative sub-clause 6A.6.6(b), is that of a duty which is subject to preconditions. That is, if:

(a) the forecast OPEX is for expenditure properly allocated in accordance with (b)(1); and

(b) the forecasts and information provided comply with the submission guidelines in accordance with (b)(3), (criteria expressed in wholly objective terms); and

(c) the total of forecast operating expenditure is determined by the AER to be a reasonable estimate in accordance with (b)(2),

then the AER must accept the forecast operating expenditure. Such a structure is similar (subject to an important difference noted below) to that found in the central decision-making provision in the *Migration Act* 1958, s65, which imposes a duty on the Minister to grant a visa if she is "satisfied" of certain matters, and to refuse the visa if not so satisfied: see *Minister for Immigration and Multicultural Affairs v Eshetu* (1999) 197 CLR 611 at [127]-[137] for a discussion of the nature of similarly-structured provisions.

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different positive content, with the result that sub-clause (a) could meaningfully be expressed in conjunctive terms.

34. Some observations should be made about sub-clause (b)(2). First, it refers to a *determination* by the AER, rather than to the formation of an opinion or of the AER reaching a state of satisfaction. As the joint judgment of Brennan CJ, Toohey, McHugh and Gummow JJ stated in *Wu Shan Liang* (at 264), "a decision which determines that "refugee status" exists differs in nature and quality from one recording the satisfaction of the decision-maker that this is the case". The use of the terminology of "determination" rather than "satisfaction" or "opinion" has consequences for the scope of judicial review: see *Buck v Bavone* (1976) 135 CLR 110 at 118-119; *Wu Shan Liang*, at 274-277; *Bruce v Cole* (1998) 45 NSWLR 163 at 184. Conferring a statutory power or duty that is made dependent upon the satisfaction or opinion of a decision-maker as to some matter "is a commonly used drafting device to ensure that judicial review is restricted": *Jabetin Pty Ltd v Liquor Administration Board* (2005) 63 NSWLR 602 at 617 [37]-[38], per Mason P.

35. However, the restriction upon judicial review that such a drafting device imposes should not be overstated, and is, in some respects, more apparent than real. As Sir Owen Dixon observed (*Avon Downs v Federal Commissioner of Taxation* (1949) 78 CLR 353 at 360, quoted with approval in *Wu Shan Liang* 185 CLR at 275, and recently discussed in *Re Minister for Immigration and Multicultural Affairs; ex parte Applicant S20/2002* (2003) 216 CLR 212), in relation to a power of the Commissioner of Taxation to make certain decisions based upon satisfaction as to the state of corporate voting power:

> His decision, it is true, is not unexaminable. If he does not address himself to the question which the sub-section formulates, if his conclusion is affected by some

> mistake of law, if he takes some extraneous reason into consideration or excludes from consideration some factor which should affect his determination, on any of these grounds his conclusion is liable to review.

36. Despite the use of the terminology of "determination", the criterion which the AER is to address, that is, whether the forecast operating expenditure is "a reasonable estimate", introduces a significant leeway of choice for the decision-maker, albeit one that is constrained by the mandatory agenda in (b)(2)(i)-(xii).

37. As noted above, the structure of clause 6A.6.6(b) is that of a duty which is subject to preconditions. The preconditions stated at 6A.6.6(b)(1) and (2) in various ways repose an exercise of judgment in the AER. This arises primarily through the use, within the criteria, of evaluative language such as "arm's length terms" - (b)(2)(vi); "reasonable estimates", "benchmark operating expenditure", "efficient TNSP" - (b)(2)(vii); ""reasonableness" – (b)(2)(viii); "efficiency of substitution possibilities" – (b)(2)(ix); "consistent with the incentives" – (b)(2)(x); "a project that should more appropriately be included as a contingent project" – (b)(2)(xii). However, once the AER determines that these criteria are satisfied, the AER has no discretion to reject a proposal but is instead required to accept it. We note that, where the AER determines that a proposal fails certain of the stated criteria, it does appear to have a discretion to accept the proposal nevertheless– clause 6A.14.3(a). The policy reasons for giving the AER the discretion to accept a forecast CAPEX or OPEX that it has determined not to be reasonable are not immediately apparent, and in our view further consideration might be given to whether this outcome was intended. The structure of this duty to accept an estimate if it is determined to be

reasonable, combined with a discretion to accept an estimate determined not to be reasonable, might result in the construction of clauses 6A.6.6 and 6A.6.7 being more skewed in favour of the TNSP than was intended. A symmetrical duty to accept if the estimate is determined to be reasonable, and to reject if is not, would be more likely to lead to a balanced outcome.

38. The determination to be made within clause 6A.6.6 (b)(2) is whether the forecast operating expenditure is "a reasonable estimate", of the required forecast OPEX. An issue that may arise from the terms of the current draft is whether the "required operating expenditure" in sub-clause (b)(2) is to be a reasonable estimate of (referring back to (a)) the expenditure "reasonably required in order to" meet the four objectives stated in (a)(1)-(4).[9] "Required operating expenditure" is not defined. From its context, it may clearly enough be a reference back to sub-clause (a). But uncertainty arises because, in making the determination, the AER is to take into account the matters identified at (b)(2)(i)-(xii). Those matters include some that are purely informational, for example in (i), (iii) and (iv). Others, like that in (ii), are substantive criteria that overlap with the substantive criteria set out in sub-clause (a)(2). The remaining criteria are substantive criteria that overlap in an uncertain way with those set out in sub-clause (a) (1)-(4), giving rise to a possible argument that (b)(2) is an exhaustive agenda, and operates independently of (a)(1)-(4). The uncertainty would be resolved if the phrase "required operating expenditure" were to be defined, for example in similar terms to those currently in (a)(1)-(4).

[9] We note that, whereas clause 6A.6.6(a)(1) relates to each regulatory year of the regulatory period, clause 6A.6.6(a)(2) relates to the regulatory control period *in toto*.

39. Some of the criteria in (b)(2) may raise other difficulties. For example, the criterion in (b)(2)(vi), referring to arrangements "that might not be on arm's length terms", will present a decision-maker with an obvious difficulty. Non-arm's length terms are, by that clause, made a mandatory consideration, but the phrase "might not be" conceals their significance. Presumably, terms that are not arm's-length are to be treated differently to those that are. A preferable approach would be to refer to "arrangements with a person other than the provider, that in the opinion of the *AER* do not reflect arm's length terms". Section 73B(31) of the *Income Tax Assessment Act* 1936 provides one example of an approach to similar issues.

40. The difficulties of construction of clause 6A.6.6 are essentially mirrored in clause 6A.6.7.

41. These difficulties are compounded by the terms of the substantive decision-making provisions.

42. Under clause 6A.14.3, the AER must approve the total revenue cap and the maximum allowed revenue as set out in the revenue proposal if "satisfied" of various matters, including in (5) and (6) that the totals of forecast CAPEX and forecast OPEX are reasonable estimates of required expenditure taking into account the matters in clauses 6A.6.6(b) and 6A.6.7(b). That is, it must decide under clause 6A.14.3, whether it is "satisfied" of matters that it has previously "determined" in deciding whether to accept the estimates under clauses 6A.6.6(b) and 6A.6.7(b). If not so satisfied of those or other matters, it may, but is not required to, refuse to approve the total revenue cap or the maximum allowed revenue.

43. Further complexity may arise from the terms of clause 6A.13 .2. Subclause (b) appears to contemplate that, where the AER has determined that forecast expenditure is not a reasonable estimate under clauses 6A.6.6(b) or 6A.6.7(b), nevertheless it may still decide that it is satisfied that the forecast expenditure is reasonably required for the purposes set out in clauses 6A.6.6(a) and 6A.6.7(a). If not so satisfied, then the AER must include in its final decision the forecast expenditure which it determines to be reasonably required for those purposes. That is, the AER first "determines" whether the forecast expenditure is a reasonable estimate of required OPEX under clauses 6A.6.6(b) or 6A.6.7(b), having regard to the mandatory decision-making agenda in those subclauses. It then considers whether it is "satisfied" under clause 6A.14.3 that the total forecast expenditure is a reasonable estimate of required expenditure under clauses 6A.6.6(b) or 6A.6.7(b), having regard to the mandatory decision-making agenda in those subclauses. If it is so satisfied, it must then approve the proposal subject to other matters. If it is not required to accept the forecast expenditure under clauses 6A.6.6(b) or 6A.6.7(b), and it is not "satisfied" that the forecast expenditure is reasonably required for the purposes set out in clauses 6A.6.6(a) and 6A.6.7(a), then it must include in its final decision the forecast OPEX or CAPEX which it "determines" to be reasonably required for the purposes set out in clauses 6A.6.6(a) and 6A.6.7(a). On the current drafting, it appears to us to be unclear whether the AER, either in deciding whether it is not satisfied, or in determining the forecast expenditure reasonably required, is bound by the mandatory decision-making agenda in clauses 6A.6.6(b) or 6A.6.7(b).

44. To achieve consistency of approach the draft should consistently use the language of "satisfaction" rather than "determination". In our opinion, such terminology affords the regulator some leeway in deciding whether to accept a forecast as reasonable, having regard to the enumerated criteria, while still permitting judicial scrutiny of the lawfulness of regulatory decisions. We have attached a redraft which endeavours to address some of the issues raised above. The consistency of that draft with other parts of the draft rule is a matter that should be raised with the drafter.

45. We refer to and repeat our short answers to questions 2 to 4 stated above.

Fifth Question: The Implications of Statutory Language and Structure

46. We are finally asked to advise generally as to the implications (if any) of using different forms of statutory language and structures in operative regulatory decision-making provisions.

47. We address these issues below. A crucial preliminary to these observations is that statutory interpretation is a purposive exercise[10] of attributing meaning to language within the context in which it is used.[11] While judicial consideration of particular phrases may cast some light

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[10] See section 15AA *Acts Interpretation Act 1901* (Cth) and section 13 *Legislative Instruments Act 2003* (Cth) extending the application of the section beyond delegated legislation to executive instruments. In New South Wales, *s 33 of the Interpretation Act 1987* (NSW) replicates section 15AA 1901; however, section 33 does not apply to instruments which are instead governed by the common law: see *Saggers v Sydney Market Authority* (1988) 66 LGRA 42 at 44; and in respect of purposive interpretation at common law, see *Cole v Director-General of Department of Youth and Community Services* (1987) 7 NSWLR 541 at 549 per McHugh JA and the authorities cited therein.

[11] For example, in *Hunter Resources v Melville* (1988) 164 CLR 234 at 241 Mason CJ and Gaudron J observe of the task of statutory interpretation: "It is a matter then of construing the relevant provisions of the Act in their context which of course includes the scope and purpose of the statute." See generally A Barak, *Purposive Interpretation in Law* (New Jersey 2005 Princeton University Press).

upon how a court is likely to interpret that phrase, the crucial question is the meaning of a phrase within its actual context (in this case, the broader context of Chapter 6A, and the entire statutory and regulatory context of the National Electricity Law and associated instruments).

48. This point is well illustrated by the recent case of *Guss v DCT* [2006] FCFCA 88, in which Gyles, Edmonds and Greenwood JJ considered the meaning of the phrase "reasonable estimate" within Part VI, Division 8 of the *Income Assessment Act 1936* (Cth).

49. Section 222AGA of the 1936 Act empowers the Commissioner of Taxation to make a reasonable estimate of tax unremitted where he or she has reason to suspect that a person (including a corporation) liable to remit deductions has failed to do so. Upon notice of such estimate being given to the person suspected of being in default, that person becomes immediately liable to pay the amount of the estimate to the Commissioner without in any way diminishing his or its original liability to account for the tax deducted.

50. The Full Court observed that, within the context of the 1938 Act, in making a reasonable estimate, the Commissioner for Taxation was entitled to have regard to anything the Commissioner thought relevant, with some examples of relevant information being contained in ss 222AGA(2). That is, the notion of reasonableness was given content by the statutory context of the provision and the criteria identified as relevant to the making of an estimate.

"Reasonable estimate"

51. The Macquarie Dictionary defines:

51.1. "reasonable" as meaning:

1. endowed with reason. 2. agreeable to reason or sound judgment: *a reasonable choice*. 3. not exceeding the limits prescribed by reason; not excessive. 4. moderate, or moderate in price: *the coat was reasonable but not cheap*.

51.2. "estimate" as meaning:

1. to form an approximate judgment or opinion regarding the value, amount size, weight etc of; calculate approximately. 2 to form an opinion of; judge. 3. to submit approximate figures, as to the cost of work to be done. 4. an approximate judgment or calculation, as of the value, amount etc of something 5. a judgment or opinion, as to the qualities of a person or thing; estimation or judgment. 6. an approximate statement of what would be charged for certain work to be done, submitted by one ready to undertake the work.

52. The term "estimate" (as it appears in s 51(1) of the *Income Tax Assessment Act 1936* (Cth)) has been considered judicially in *Australia and New Zealand Banking Group Ltd v FCT* (1994) 119 ALR 727 at 741, per Hill J, at 741 as follows:

> The concept of ``estimate'' does not involve arbitrarily seizing upon any figure. What is involved is the formation of a judgment or opinion based upon reason. That judgment or opinion must necessarily be made bona fide but it need not be exact for the process of estimation involves a process of approximation. As Lord Loreburn said in *Sun Insurance Office v Clark* [1912] AC 443 at 454:
>
> > There is no rule of law as to the proper way of making an estimate. There is no way of estimating which is right or wrong in itself. It is a question

of fact and figures whether the way of making the estimate in any case is the best way for that case.

53. Hill J proceeds (at 741):

> The concept, if it be a separate concept, that the estimate made must be a reasonable one (as distinct from one based upon reason) appears to stem from the judgment of Menhennitt J in *RACV Insurance*.
>
> An earlier case of *DCT (NSW) v Manufacturers' Mutual Insurance Ltd* (1931) 31 SR(NSW) 575, had stressed that a provision for claims made by an insurer, although ``uncertain'', had to be ``susceptible of more or less accurate estimate'' (at 585 per Ferguson J).
>
> It may well be that the process of reasoning adopted by Menhennitt J in *RACV Insurance* was no more than to say that because on the evidence the provision in the *RACV Insurance* case was reasonable it was therefore a real estimate, as distinct, for example, from a guess. Be that as it may, the requirement that a provision be reasonable was accepted by Newton J in the *Commercial Union* case. The evidence in that case was that the method of calculation adopted was a proper method. This was notwithstanding in respect of a provision of $5,864,866 it produced an underestimate by an amount of more than $2,400,000. But the fact that the estimate was wrong did not mean that it was unreasonable. Newton J in *Commonwealth Aluminium*, supra, at 4160-1, after stating the requirement that the quantum of liability must be capable of reasonable estimation said (at 4161):
>
> > In this context I think that the quantum of a liability is ``capable of reasonable estimation'', if it is capable of approximate calculation based on probabilities: see para 2 of the definitions of the noun ``estimate'' in the *Shorter Oxford English Dictionary* (3rd ed, 1950); see too *JJ Savage & Sons Pty Ltd v Blakney* (1970) 119 CLR 435 at 442.

54. Hill J concludes (at 742):

> There was nothing in the evidence to suggest that the determination of the provisions was otherwise than made by reference to a bona fide estimate. The means of calculation was not dissimilar from that adopted in the *RACV Insurance* case. What made the calculation difficult, no doubt, was that with the adoption of a new scheme for workers' compensation there was not available a long historical experience permitting the actuary to say that the figure chosen had statistical accuracy. But it does not follow from that either that the amount involved was incapable of estimation or that the calculation made was an unreasonable one (if that be a different requirement). In my view the making of an estimate by reference to a case by case analysis of files by a person expert in the field is a reasonable way of making such an estimate and indeed ultimately the only way such an estimate can be made. That was the estimate adopted in the bank's accounts which were audited and which, so far as appears, was subject to no reservation by the auditors in the certification of those accounts. In my view the present is not a case where it can be said that there can be no process of estimation or that no process of estimation was in fact made because the figure adopted was not reasonably arrived at. Rather, the establishment of provisions in the present case was an exercise capable of approximate calculation based on probabilities.

55. In *Telstra Corporation Limited* [2006] ACompT 4, the Australian Competition Tribunal observed, in relation to provisions within Part XIC of the *Trade Practices Act 1974* (Cth):

> **[63]** Telstra submitted that a term relating to the price charged by an access provider will be reasonable if the price will permit the access provider to recover no more than a reasonable estimate of the efficient costs of delivering that service during the period of an undertaking. Insofar as Telstra's submission is tied to the period of the undertaking, a period it alone controls, we do not accept that submission (see para [107] below). In this area of analysis there is no one correct or appropriate figure in determining reasonable costs or a reasonable charge. Matters and issues of judgment and degree are involved at various levels of the

analysis. In considering whether Telstra's estimates of its costs are reasonable we are not driven to considering whether the Commission's or other parties' views or assessment of those costs are more reasonable. Nor do we enquire whether Telstra's method or approach in estimating its costs is the correct or appropriate approach. If Telstra's method or approach in estimating its costs is reasonable having regard to the statutory matters set out in ss 152AH and 152AB then the matter rests and a comparison with the $9.00 monthly charge is then to be made: *Application by GasNet Australia (Operations) Pty Ltd* (2004) ATPR 41-978 at [29]. Put shortly, our inquiry is whether the method employed by Telstra at each level of determining the costs of its LSS is reasonable having regard to the statutory matters identified in s 152AH and the objectives set out in s 152AB.

[64] It is clear that the relevant inquiry brings into consideration the matters set out in ss 152AH and 152AB of the Act. For in determining whether a term relating to price is reasonable, regard must be had to the matters set out in those sections. As Telstra acknowledged, in coming to a decision whether or not a term relating to a price or charge is reasonable it is necessary for the Tribunal to look at the means by which the price or charge was derived and to consider whether the method adopted was, in the circumstances, reasonable. That, in turn, requires evaluating the method adopted by reference to the same matters set out in ss 152AH and 152AB.

[67] ... In a number of respects we are operating in areas where there is no one specific regulatory, economic, accounting or financial answer, and where there may be a number of approaches to the determination of relevant costs or their allocation which may be regarded as reasonable. Our inquiry is directed to whether Telstra's $9.00 monthly charge in its access undertaking is reasonable having regard to the statutory matters set out in of ss 152AH and 152AB of the Act.

[121]... We emphasise that the issue is not whether there is a more reasonable approach to cost allocation than that advanced by Telstra, but is rather whether

> Telstra's approach to cost allocation is reasonable having regard to the matters identified in ss 152AH and 152AB.

56. It is apparent, therefore, that the requirement to provide a reasonable estimate in the context of clause 6A.6.6 of the Draft Revenue Rules is likely to be satisfied by various different estimates falling along a continuum of reasonableness, having regard to the criteria stipulated therein.[12]

57. Beyond the context of the phrase "reasonable estimate", the term "reasonable" has been considered judicially in many different contexts, as arising in various composite phrases. As a result of the variety and context of these uses, there is little benefit to be obtained from rehearsing uses that bear little relation to the current statutory context.[13]

"Best Estimate"

58. The Macquarie Dictionary relevantly defines "best" as meaning:

> **1**. of the highest quality, excellence or standing: the best judgment. **2.** most advantageous, suitable, or desirable: the best way...**6.** most excellently or suitably; with most advantage or success. **7**. in or to the highest degree; most fully...**11**. utmost or best quality...

59. The composite term "best estimate" has not been judicially considered.

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[12] In *The Queen v Hunt; Ex parte Sean Investments Pty Ltd* (1979) 180 CLR 322 at 329, Mason J observes that in having "regard" to certain matters a court is required to take those matters into account and to give weight to them as fundamental elements in making its determination.

[13] For example, the expression "reasonable cost" is defined in section 11(1) of the *Frustrated Contracts Act 1978* (NSW) as meaning, "in relation to performance received under a frustrated contract...an amount that would be fair compensation to the performing party for any detriment suffered by that party in reasonably paying money, doing work or doing or suffering any other act or thing to the extent to which the detriment was suffered for the purpose of giving the performance so received."

60. In the context of s 18(1) of the *Liquor Act 1982* (NSW), the Court of Appeal in *Meagher v Stephenson* (1993) 30 NSWLR 736, observed in relation to the expression, "best market price":

> The Licensing Court was required to determine whether an off-licence was available at a reasonable market price. Unless it had regard not only to the price being asked but also to the conditions of sale, it could not, in our opinion, determine whether the price being asked was a "reasonable market price". The price of an off-licence, the sale of which is not conditional upon it being removed to another location, would ordinarily be less than the price that would be asked, other things being equal, for a sale which is conditional because the notional purchaser in the second case does not run the risk that the Licensing Court might not allow the licence to be removed. Once that proposition is accepted, the submission that the Licensing Court erred because it had regard to the circumstance that the sale was not conditional on removal must be rejected. We are of the opinion, therefore, that it has not been shown that the Licensing Court erred in its interpretation of s 18(10) of the *Liquor Act* 1982.

61. The expression "highest and best value" has been considered judicially on various occasions but provides little assistance in the current context. See for example: *Equity Trustees Executors and Agency v Melbourne and Metropolitan Board of Works* [1994] 1 VR 534 and *Adelaide Clinic Holdings Pty Ltd v Minister* (1988) 65 LGRA 410.

62. It is clear, however, that "best", as a superlative, connotes a single and reasonably objective estimate. A statutory provision that requires that only the best estimate be approved is similar to a requirement in administrative law that a decision-maker reach the correct or preferable decision, and is likely to repose in a regulatory decision-maker a high degree of judgment

as to which estimate is the best, and (subject to the manner of specification of statutory criteria) the means by which the best estimate is ascertained.

63. Beyond the notions of a "best" or "reasonable" estimate, the Draft Revenue Rules could include notions such as:

63.1. the estimate of the operating expenditure, or capital expenditure, that would be required by a prudent TNSP;

63.2. the estimate of the operating expenditure, or capital expenditure, that would be required by an efficient TNSP; or

63.3. the estimate that would be proposed by a prudent/efficient TNSP in the circumstances of the TNSP submitting the proposal.

64. The first two notions are evaluative in the same manner as is a test of reasonableness. In each case, content must be given to the term "prudent" or "efficient". Unlike the term "reasonable", each of "prudent" and "efficient" invoke economic concepts, with issues of interpretation likely to be contested, and settled by reference to expert economic, engineering or accounting advice or evidence. The third notion, while still evaluative, is rendered more subjective by the phrase "in the circumstances of the TNSP submitting the proposal". The phrase qualifies the notion of efficiency or prudence to the circumstances of a particular applicant, and implies that efficiency is not to be assessed objectively but contextually, in light of actual opportunities and constraints confronting the TNSP.

65. We note that, in a related regulatory context, regulation 3(1) of the *Dampier to Bunbury Pipeline Regulations 1998* (WA) defines "reasonable and prudent person" as meaning: "a person acting in good faith with the intention of

performing his or her contractual obligations and who in so doing and in the general conduct of his or her undertaking exercises that degree of skill, diligence, prudence and foresight which would reasonably and ordinarily be exercised by a skilled and experienced person complying with recognised standards and applicable laws engaged in the same type of undertaking under the same or similar circumstances and conditions". (See, in similar terms, regulation 3(1) of the *Gas Referee Regulations 1995* (WA)).

66. An alternative approach is to avoid the use of value-laden terms of uncertain content by requiring the AER to accept the estimate if it determines that it is "the required operating expenditure" for the period. This is an intermediate position: it eliminates the blurring factor of 'reasonable estimate' that TNSPs might use to justify error on the high side of the actual requirement, but does not impose the superlative standard inherent in the 'best estimate'. It does, however, impose a very narrow range, indeed on one view a single figure, and requires the regulator to determine if the estimate is that amount which is required. It is subject to the same essential difficulty as the 'best estimate' standard, in requiring the AER to form its own view of the amount required rather than assessing the reasonableness of the estimate supplied.

67. We should observe that in practice TNSPs may be likely to pitch their estimates above their own 'best estimates' of what they require, but will be constrained in doing so by a desire to avoid the outcome that their estimate is rejected, and the regulator's own estimate substituted. If the TNSP's estimate is rejected as not reasonable, it might be expected that the amount the regulator will determine for itself will fall significantly below

the top of the reasonable range, and perhaps below the median of that range. That is an outcome that rational TNSPs may try to avoid, and the facility for a regulator-determined amount in substitution for the TNSP estimate may moderate any tendency toward ambit claims.

Statutory Structure

68. As noted above, the structure of clause 6A.6.6 and 6A.6.7 of the Draft Revenue Rules is that of an affirmative duty which is subject to jurisdictional preconditions. That is, if:

(a) the forecast OPEX is for expenditure properly allocated in accordance with (b)(1); and

(b) the forecasts and information provided comply with the submission guidelines in accordance with (b)(3), (criteria expressed in wholly objective terms); and

(c) the total of forecast operating expenditure is determined by the AER to be a reasonable estimate in accordance with (b)(2),

then the AER must accept the forecast operating expenditure.

69. An alternative statutory structure is exemplified by s 152BV of the *Trade Practices Act 1974* (Cth); one of the provisions considered by the Australian Competition Tribunal in *Telstra Corporation Limited* [2006] ACompT 4.

70. Section 152BV provides:

(2) The Commission **must not accept** [an] undertaking **unless**:

(a) the Commission has:

(i) published the undertaking and invited people to make submissions to the Commission on the undertaking; and

(ii) considered any submissions that were received within the time limit specified by the Commission when it published the undertaking; and

(b) the Commission is satisfied that the undertaking is consistent with the standard access obligations that are applicable to the carrier or provider; and

(c) if the undertaking deals with price or a method of ascertaining price--the Commission is satisfied that the undertaking is consistent with any Ministerial pricing determination; and

(d) the Commission is satisfied that the terms and conditions specified in the undertaking are reasonable; and

(e) the expiry time of the undertaking occurs within 3 years after the date on which the undertaking comes into operation.

71. In *Telstra Corporation*, the Tribunal (per Goldberg J, Mr R Davey and Professor D Round) makes the following observations in respect of the statutory structure:

> **[20]** Telstra was well aware that the statutory scheme required the Commission (and on review the Tribunal) to be satisfied affirmatively of the reasonableness of the terms and conditions of the access undertaking proffered by Telstra before it could approve the access undertaking. Not only was Telstra aware of the fact that it bore this onus of affirmatively proving the reasonableness of the terms and conditions of the undertaking, it was also aware of the fact that if it received an adverse result from the Commission and wished to have the Tribunal review the decision of the Commission, then it was limited in the material which it could place before the Tribunal in accordance with s 152CF(4) of the Act.

> **[46]** ... whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs. An access provider should also recognise that if the Commission decides against accepting the access undertaking and rejects it and the provider wishes to seek review of the Commission's decision before the Tribunal, it would be necessary to establish before the Tribunal that its costs are efficient. It is apparent from the statutory framework that the Tribunal is limited in respect of the material to which it may give consideration as it is limited to the material which was before the Commission and any material referred to in the Commission's decision. Put shortly, if an access provider wishes to establish before the Commission, or needs to establish before the Tribunal, that its costs are efficient, it will need to have put material to that effect before the Commission.
>
> **[172]** In order to accept Telstra's access undertaking we have to be satisfied affirmatively that the terms and conditions specified in the undertaking are reasonable: s 152BV(2)(d).

72. We noted above that, in the context of administrative decision-making, use of the language of the burden or onus of proof can be distracting. We repeat those observations in respect of the decision in *Telstra Corporation Limited*. Proper analysis of a provision such as s 152BV requires identification of:

72.1. the jurisdictional limits of the decision-maker's decision-making capacity;

72.2. the nature of the power or duty conferred or imposed upon the decision-maker once the jurisdictional limits are satisfied; and

72.3. the nature of the material that an applicant must put before the decision-maker in order to permit or require the decision-maker to approve a proposal submitted by the applicant.

73. While clause 6A.6.6 of the Draft Revenue Rules differs from section 152BV of the Act insofar as the former is framed in positive terms ("must accept if...") while the latter is framed in negative terms ("must not accept unless..."), in either case each of the above steps must be satisfied, and in either case, an applicant will be required affirmatively to demonstrate certain stipulated matters to the decision-maker. These matters are, in turn, determined by the criteria by reference to which a decision-maker is permitted or required to make a decision.

74. In summary, the degree of flexibility which a decision-maker has in making decisions is a function of various elements of the language and structure of the statutory provision, including:

74.1. whether the statute confers a power, discretion or duty upon the decision-maker:

a where the statute uses permissive language ("may") the decision-maker enjoys a large measure of discretion as to the ultimate decision it reaches;

b where a statute uses mandatory language ("must") the decision-maker does not (subject to context) enjoy a discretion; once certain statutory criteria are met, the decision-maker's obligation is engaged;

c where a statute uses negative mandatory language ("must not...unless") there is a prohibition on making certain decisions unless satisfied of certain facts or judgments. Whether there is a residual discretion in circumstances where the decision-maker is satisfied as to those matters will depend upon the context and surrounding provisions;

74.2. the criteria to which a decision-maker is to make reference. These will determine the degree of flexibility that is possible and permissible within decision-making. To the extent that the criteria are deeply evaluative or subjective, the regulator will enjoy lee-ways of choice in respect of the judgment it exercises in deciding whether the criteria have been satisfied. If the criteria are factual or objective, fewer such choices exist; and

74.3. within the context of the above exercise of judgment, the standard to be met by a decision-maker in respect of the fulfilment of stated criteria will also be relevant to the degree of flexibility enjoyed by a decision-maker. In this regard, we refer to the discussion above of the terms "satisfied", "of the opinion" and "determines".

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Chambers
24 October 2006