Processes for stakeholder negotiation for electricity network regulation

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1 Introduction

This submission addresses the matter of consumer engagement in energy network regulation, discussed in section 21.2 of the PC's draft report. The PC advocates greater use of negotiated settlements, which would involve:

> consumers and appointed consumer representatives taking an active role in negotiating price and quality issues with providers, with the AER then approving (or otherwise) the settlements.[2]

The PC proposes that a single consumer body be established with expertise in economic regulation and energy markets, and with adequate public funding. This body would participate in regulatory processes and in negotiating settlements with network businesses.

In support of these proposals of the PC, this submission explores alternative procedures to accommodate negotiation between regulated utilities and consumer representatives in the context of periodic price determinations for energy network utilities in Australia. This includes reviewing some of the case studies examined by Stephen Littlechild, a principal advocate of stakeholder negotiation in economic regulation,[3] and comparing them with the negotiated

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[1] The views expressed in this paper are the personal views of the author and are not the views of his employer, the Essential Services Commission of Victoria. Alan Snyder, of the Universities of San Diego & Melbourne, has provided valuable comments.

[2] PC, 'Electricity Network Regulatory Frameworks, Draft Report, Volumes 1 & 2' (2012), p.711.

[3] Littlechild S, 'Constructive Engagement and Negotiated Settlements – a Prospect in the England and Wales Water Sector?' (University of Cambridge Electricity Policy Research Group, 2008), www.eprg.group.cam.ac.uk/tag/littlechild/ viewed 22 February 2012; Littlechild

rulemaking procedure (or 'reg-neg') developed in the USA. This comparison provides some insights into process elements that may fit well with energy network price regulation in Australia.

Stakeholder negotiation offers scope to better identify and reflect the priorities of customers in regulatory outcomes. Palast *et al* find that public participation in setting prices and standards of utility services produces better outcomes for consumers.[4] But it should be implemented in a way that is complementary to the regulatory principles of transparency and accountability.

The aim of this submission is to explore practical issues of regulatory process design to accommodate negotiation between regulated utilities and consumer representatives in the context of periodic price determinations for energy network utilities in Australia. The specifics of the process within which stakeholder negotiation takes place will be important for its effectiveness. It is said that administrative procedures form the ground rules of a regulatory regime, and:

> … procedural reforms of the regulatory state's decision-making apparatus may very well go far to answer criticisms about the inevitability of regulatory failure.[5]

The remainder of this submission is in four parts. The first briefly outlines a typology of different regulatory processes (drawn from the USA) and characterises the nature of processes typically used in Australian utility price regulation. The second summarises the case for stakeholder negotiation in utility regulation, and the examples of customer engagement and negotiated settlements highlighted by Littlechild. The third part discusses the negotiated rulemaking process used in the USA, canvassing some of its strengths and weaknesses. Part four makes comparisons and identifies process elements that

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S, 'Regulation, Customer Protection and Customer Engagement' (Working Paper 1119, Electricity Policy Working Group, 2011).

[4] Palast G, Oppenheim J and MacGregor T, *Democracy and Regulation: How the Public Can Govern Essential Services* (Pluto Press, London, 2003).

[5] Croley S, 'Theories of Regulation: Incorporating the Administrative Process' (1998) 98(1) *Colum. L. Rev.* pp 7, 89.

may fit well with utility price regulation in Australia.

2 Utility regulation process

2.1 Regulation processes in general

Since most of the examples of negotiation in rulemaking discussed here are from the USA, it is useful to briefly describe some aspects of US administrative law processes. There are said to be two fundamental kinds 'regulation', namely: rules, which result from agencies' rulemaking processes; and orders, produced by adjudication processes.[6]

Rulemaking processes conducted by agencies can be informal or formal. The informal approach is the 'notice-and-comment' process, which requires public notification of proposed rules with an opportunity for interested parties to make comments. Comments must be given consideration when the decision is made about a proposed rule. In the formal approach the agency must conduct a hearing in which the parties provide testimony, present evidence taken on a record, and witnesses are cross-examined. Any party can participate. US rate-making cases are usually processes of this kind.[7]

There are variations on these two models. Negotiated rulemaking, which will be described in detail, is a variation on the 'notice and comment' approach. There is also 'hybrid rulemaking', in which agencies conduct public hearings in the course of developing a rule, but in other respects the process is informal—but no longer widely employed.[8] Of key importance is that agencies have greater discretion with informal rulemaking processes, whereas formal processes are subject to wider grounds for judicial review.[9]

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[6] Ibid, p 106.

[7] Ibid, p 107.

[8] Ibid, p 112.

[9] In the USA, persons aggrieved or adversely affected by agency actions, including agency rulemaking and implementation of rules, have the right to seek judicial review of those actions. However, this right does not extend to suits aimed at forcing agency action. A court can set aside an informal agency rulemaking if "arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with the law." But the court has wider grounds to set aside formal rulemaking or adjudication, which are examined more critically and must be

Adjudication is the determination of matters in dispute between two or more parties by a person sitting in judgement, and resembles decision-making by a court.[10] In the USA, formal agency adjudication processes are presided over by an administrative law judge in a strictly formal process. This mitigates the conflicting roles of the agency as a neutral decision-maker and potentially one of the parties to the matter. The outcome is an order issued by the judge.

Adjudication processes are less open than rulemaking processes. Although they can have far reaching consequences, parties other than those in dispute (which may be the agency and some party) are only included in certain circumstances. Agencies may have discretion to permit an intervenor, and some have funded public intervenors. But in the USA, this practice is becoming less common.

Although more open, notice-and-comment processes may tend to favour narrow well-organised interests that can provide comprehensive and detailed submissions that require detailed response by the agency, and thus more influential. Available research suggests that regulated businesses can commit much greater resources to these processes than other stakeholders.[11] This is one reason why initiatives to improve stakeholder engagement are considered important.

2.2 Utility regulation in Australia

In the national framework for electricity network regulation by the Australian Energy Regulator (AER), the AER's role includes:

(i) classifying those services that will be subject to price control and those for which terms and conditions are negotiated between the regulated business and the customers of those services

(ii) setting price caps every five years that apply over the following five years for the price controlled services

(iii) establishing cost allocation and ring-fencing requirements

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supported by "substantial evidence". Jeffrey Lubbers, *A Guide to Federal Agency Rulemaking* (4th ed, ABA, Chicago, 2006) p 7.

[10] Croley, above n 5, p 113.

[11] Ibid, p 131.

(iv) annually approving price proposals submitted by businesses

(v) deciding on any claims for cost pass-through as they arise, and

(vi) resolving any disputes relating to the negotiated services.

When carrying out these functions it complies with the principles, methodologies, procedures and other requirements specified in the National Electricity Rules (NER). Functions (i) and (ii) form part of a 'distribution determination' made every five years, which also includes various mandatory incentive arrangements. The AER can issue guidelines in relation to all of the matters listed above, and rules in relation to the negotiation framework for the negotiated services, and information provision.

The notice-and-comment process is used for making an electricity network determination, similar to the informal rulemaking process used in the USA.[12] The AER publishes a 'framework and approach' and the proposals of the regulated businesses for public comment through written submissions, and later does the same with the draft decision.[13] The process also has features of the hybrid rulemaking process. Stakeholder forums are sometimes held in the early stages of the process, and a public 'predetermination conference' must be held after the draft decision to hear oral submissions. AER can choose the procedure it adopts for the conference, which it describes as a public forum. Once made, the distribution determination governs the conduct of the affected regulated businesses over a five-year period. Annual approval of price variations ensures they are consistent with the distribution determination.

This process is similar to that used in the UK for determining network charges, but differs from the formal rulemaking or formal adjudication procedures used for rate cases in the USA.

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[12] Notice-and-comment processes are largely confined to 'standard services'. Ancillary or idiosyncratic services may be negotiated services subject to an informal adjudication process if a dispute arises between parties. The process that would be adopted for these kinds of access disputes is not always well documented. For example, there is no finalized guideline for dispute resolution under chapter 6 of the NER.

[13] *National Electricity Rules Version 47*, 2011, ch 6; AER, 'Final Decision: New South Wales Distribution Determination 2009–10 to 2013–14' (2009).

3 Use of negotiated outcomes in price regulation processes

Two broad approaches are available for widening the role of stakeholder negotiation in the process of regulation. One approach would widen the range of negotiated services and narrow the scope of 'standard services' subject to price control. However, adjudication processes largely confine participation to disputing parties. They offer limited scope for broader stakeholder engagement. Other options focus on introducing innovations into the notice-and-comment process to provide greater scope for bargaining between stakeholders. This is said to be less burdensome and to produce better and more innovative outcomes for consumers.[14]

3.1 Characteristics of negotiated settlement

The main elements generic to most negotiated settlement processes are:

- In the first instance the regulator may assess utility proposals and provide comment, which assists negotiators understand its perspectives.
- The regulator may provide ongoing assistance to consumer representatives if needed (eg clarification of analysis or similar technical support), or a statutory consumer representative may lead the consumer representation and be resourced to obtain analysis or advice.
- The regulator will stand by to determine the outcome if an agreement can't be reached, or it will revert to a rate case.
- The regulator will usually review and comment on a draft agreement to ensure it meets statutory requirements and objectives, and reflects all interests.
- Finally the regulator will formally endorse final agreement if applicable procedural and statutory requirements have been met.

3.2 Examples of negotiated settlement

Littlechild explores examples from the USA, Canada and Europe, where

[14] Littlechild S, 'The Process of Negotiating Settlements at FERC' (Working Paper No 1105, Electricity Policy Working Group, 2011) pp 27-28.

customers or their representatives take an active part in negotiating prices and quality standards with regulated service providers.[15] The regulator's role is limited to endorsing an agreement, or determining the terms and conditions of supply if no agreement can be reached. It is useful to briefly review some of these examples.

3.2.1 Non-utility contexts

Some gas or oil transmission pipelines in the USA and Canada. In the USA, the Federal Energy Regulatory Commission (FERC) has, since the 1960's, actively encouraged negotiated settlement of interstate gas pipeline tariffs prior to judicial adjudication by an appointed administrative law judge in a rate case.[16] FERC-issued regulations govern settlement practice. Settlements have increased from approximately half of the cases in the 1960s to about 90% in recent times.[17] After initial offers are made, negotiations take place at settlement conferences. If agreement is reached, it is formalised in a Settlement Document, which is subject to judicial certification and FERC authorisation. If agreement is not reached, the rate case proceeds. In that case, none of the discussions, statements or positions that were part of the negotiations can be used in evidence.

The process for determining oil and gas pipeline rates in Canada is similar. The National Energy Board (NEB) conducts rate case hearings if there is no negotiated settlement. It facilitates settlements by issuing guidelines for settlement and annually publishes a generic cost of capital to be used as a benchmark by stakeholders in negotiations. When endorsing a negotiated settlement, NEB judges the settlement by the process leading up to it, not on its own view of the terms. By the late 1990's, settlements had virtually supplanted rate cases.[18]

Airports are another sector discussed by Littlechild. At a number of German

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[15] Littlechild (2008) & (2011), above n 4.

[16] Gas pipeline rate cases were greatly reduced after the 1992 mandated unbundling of gas production, transportation and sales activities.

[17] Littlechild, above n 14, p 27.

[18] Doucet J and Littlechild S, 'Negotiated Settlements: The Development of Economic and Legal Thinking' (Working Paper No 0604, Electricity Policy Working Group, 2006).

airports there was a move away from administered 'cost plus' price regulation from 2002, in favour of 'framework agreements' between airports and airlines. These established price paths over time for airport services. Frankfurt, Hamburg, Dusseldorf and Hannover all followed this model (although at least one reverted to the former regulatory model).[19] The agreements reflected the preferences of the parties, and had an emphasis on quality monitoring, consultation, and the revenue risk sharing.

For the British Airports, the Civil Aviation Authority (CAA) in 2005 adopted a process of constructive engagement in which certain pricing inputs such as traffic forecasts, service quality requirements and investment plans were negotiated between the airport and airlines. Operating cost forecasts, the cost of capital and the final price control remained the responsibility of the CAA.[20] Reviewing this process, the UK Competition Commission saw merit in constructive engagement in principle, but it highlighted the need for clear procedures, a formal framework for the provision of information from airports to airlines, and a dispute resolution procedure at each stage.[21] It was also concerned about the lack of focus on price in stakeholder negotiations resulting from the division of responsibilities between the regulator and stakeholder negotiators. All of the elements of a determination (such as capital works plans and service quality standards) are usually related to price. Consideration of just some of the issues in isolation can lead to inefficient outcomes.

The foregoing examples are not directly relevant to the regulation of electricity or gas distribution networks. For some infrastructure where there are relatively few large customers, private long-term contracts can be substituted for regulatory price control. Regulation is only needed in the last resort if agreement cannot be reached. Airports, long-distance gas pipelines and railroads may be examples. But the market for energy network services differs:

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[19] Littlechild S, 'German Airport Regulation: Framework Agreements, Civil Law and the EU Directive' (University of Cambridge Electricity Policy Research Group, 2010), www.eprg.group.cam.ac.uk/tag/littlechild/.

[20] Littlechild (2011), above n 4, pp 7-9.

[21] Littlechild (2008), above n 4, pp 14-15.

> The major limitation on private contracts as a substitute for government regulation is the presence of small customers. The difficulty is not that the small customers have less bargaining power than the utility, … it is that the transaction costs of negotiating contracts with small customers may be high relative to the value of the services involved.[22]

Several Australian regulatory frameworks already provide for terms and conditions to be determined by negotiation between users and regulated businesses for services such as long-distance gas pipelines, railroads and airports. Some provide users with rights of dispute resolution if agreement can't be reached. The examples do not provide for multilateral negotiations, as is the case for the examples cited from Littlechild, but they are in markets where there are a small number of large buyers.

3.2.2 Utility contexts

Other examples of negotiated settlement include energy or telecommunications utilities. In Florida USA, the Florida Public Services Commission (FPSC) is the regulator of utilities in that state. Its normal regulatory procedure is to conduct a formal court like procedure at the end of which it makes a decision. It has a policy of encouraging settlements made in good faith. Florida also has a statutory consumer advocate, the Office of Public Counsel, which has increasingly taken the lead role in negotiating network tariff rates with telecommunications and energy utilities. Over the seven years to 2002, approximately 30% of telecommunications and energy utility price reviews were settled, growing further since then.[23] The available evidence suggests that the elements of settlements have been innovative and customers have tended to obtain better outcomes when compared to formal rate cases.[24] Settlements may take the form of four-year agreements, which may include rate freezes or reductions and revenue-sharing incentive plans which provide for sharing of

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[22] Gomez-Ibanez J and Meyer J, 'The Rediscovery of Private Contracts: U.S. Railroad and Airline Deregulation' in Gomez-Ibanez J, *Regulating Infrastructure: Monopoly, Contracts and Discretion* (Harvard, Cambridge, 2003) p 189.

[23] Littlechild S, 'The Bird in Hand: Stipulated Settlements and Electricity Regulation in Florida' (Working Paper No 0705, Electricity Policy Working Group, 2007) pp 2, 32.

[24] Ibid.

the risk of unexpected demand outcomes.

The setting of utility rates in Alberta Canada has similarities to Florida. Alberta has a Utilities Consumer Advocate (UCA). The UCA represents Alberta residential and small commercial utility consumers in regulatory hearings before the Alberta Energy and Utilities Board (AEUB). This is intended to reduce duplication of interveners and regulatory costs. Parties have settled around one quarter of electricity and gas rate cases before the AEUB.[25]

In these examples related to standard utility services, negotiation is essentially a pre-trial settlement. A negotiated settlement obviates the need for the rate case, and consequently such processes can reach agreement between consumer representatives and utilities without any formal public consultation process. This is quite different from the emphasis on formal public consultation in utility price determination in Australia. This difference suggests that consideration is needed on how the aim of more direct stakeholder participation can be achieved in the Australian institutional environment without diminishing the existing public consultation processes.

The UK energy regulator, Ofgem, rejected negotiated settlement approaches in its 2010 frameworks review.[26] While it accepted the need for customers and their representatives to have greater participation and a more influential role in price determinations, it did not consider any delegation of its responsibilities to consumer representatives to be appropriate because: consumer representative groups are not sufficiently representative of consumers; future consumers would not be represented; and consumer representatives are not sufficiently able to carry out necessary analysis or make complex trade-offs between the interests of different consumers.

The PC's proposed statutory consumer representative is supported by observations in this section. Both of the cited examples of negotiated settlement in utility contexts, where there are many small customers, have a statutory

[25] Littlechild (2008), above n 4, pp 14-15.

[26] Littlechild (2011), above n 4, pp 9-10.

consumer representative. Ofgem's arguments also imply the likely need for such a body to complement existing consumer representative bodies, but not displace them.

4 Negotiated rulemaking

An alternative model for stakeholder negotiation is negotiated rulemaking ('reg-neg'). Reg-neg was introduced in the USA over two decades ago to address perceived problems with notice-and-comment rulemaking, such as being excessively adversarial and antagonistic, with long formulation and implementation delays, and frequent judicial challenges. These shortcomings were seen as manifestations of procedural constraints, which inadequately engaged stakeholders and provided little scope for direct interaction between them. The proposed solution was a rulemaking procedure that focussed more on achieving consensus between different interests by enabling them to resolve their differences through face-to-face negotiation.[27] It is now one of a number of 'consensus-based processes' for rulemaking.[28]

4.1 Overview

Before a government agency issues a proposed rule, a negotiating committee is formed with a balanced representation of all interests to conduct a negotiation process concerning the substance of the rule. The main parties affected by the rule are represented, as is the government agency responsible for making the rule. The aim is to reach consensus on the proposed rule. If so, it is adopted by the government agency as the proposed rule it will consult on (subject to it meeting its legal obligations). The negotiating committee's status is advisory only. The process is used only to develop the initial proposal, after which the

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[27] Coglianese C, 'Assessing Consensus: The Promise and Performance of Negotiated Rulemaking' (1997); Kerwin C and Furlong S, *Rulemaking: How Government Agencies Write Law and Make Policy* (4th ed, CQ Press, Washington, 2011), p 206; Lubbers J, 'Achieving Policymaking Consensus: The (Unfortunate) Waning of Negotiated Rulemaking' (2008) 49 *S. Tex. L. Rev.* p 994; Harter P, 'Collaboration: The Future of Governance' (2009) 2 *J. Disp. Resol.*

[28] Other consensus-based approaches include one-at-a-time consultations, information exchanges, workshops, roundtables and policy dialogues. Centre for Public Policy Dispute Resolution, *Texas Negotiated Regulation Deskbook* (1996).

standard notice-and-comment process is conducted. The government agency remains responsible for deciding the rule at the end of the process.

Unlike negotiated settlement, if agreement is reached, it is not simply subject to endorsement by the regulator, and if agreement can't be reached it does not revert to an adjudication process. Whether agreement is reached or not, a notice-and-comment procedure follows the negotiation stage. But if agreement has been reached in the negotiation stage, then that outcome will be the proposal presented by the government agency for public comment (eg, the draft price determination for an electricity network). If agreement can't be reached, the agency will put forward its own proposal (or draft determination), but will benefit from the perspectives gained from the negotiation stage. In short, the negotiation process is a supplementary step, before the notice-and-comment process commences, and does not do away with or alter that process.[29]

Reg-neg can be resource intensive and will only be suitable when interested parties (including the agency) are willing to commit the effort needed to participate. It may not be a productive approach where the likelihood of consensus is too remote. It is unnecessary when there is little controversy associated with the development of a rule.[30] It is best suited to circumstances where the subject is complex or controversial and the agency would find it difficult to form a confident view. The agency may have less information than the stakeholders and is willing to be guided by consensus.[31] There needs to be enough issues for the parties to trade-off through negotiation, and the stakeholders must be prepared to negotiate in good faith with the aim of reaching a consensus.

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[29] The use of reg-neg does not exempt the agency from any statutory obligation, delegate its ultimate decision-making function, or remove any obligation to produce economic or other analysis. A rule established through negotiated rulemaking is treated no differently to a rule made by any other valid rulemaking process. Once decided, a rule may be subject to judicial review. However, certain elements of the negotiated rulemaking process are not subject to judicial review. Centre for Public Policy Dispute Resolution, above n 28, p 12.

[30] Kerwin and Furlong, above n 27, p 206.

[31] Centre for Public Policy Dispute Resolution, above n 28, p 10.

It is also important that no one stakeholder has overwhelming power. A well-resourced consumer representative and balanced representation of all interests would be essential.[32]

4.2 Elements of the reg-neg process

The elements of the reg-neg process are set down in the *Negotiated Rulemaking Act of 1996* (USA) and resources such as the *Negotiated Rulemaking Sourcebook*.[33] Whereas negotiated settlement appears to be essentially a private negotiation process, reg-neg is a formal process. Meetings of the negotiating committee are normally open to the public,[34] and documents generated by the committee are public documents.

The rulemaking agency participates on the committee as an interested party, not as an observer. Representatives of the government agency have the same roles and rights as other members of the committee. The meetings are chaired by an neutral facilitator/mediator chosen by the committee.

The committee compiles and submits a report to the agency. This may be a narrative of the committee's deliberations and its ultimate resolutions, and any matters unresolved. If the committee reaches a consensus the report includes its proposed rule. Committee records should be complete, identifying all of the issues discussed and the positions taken.

4.3 Strengths & weaknesses

In reg-neg parties can make trade-offs, identify innovative solutions and reach outcomes that are acceptable given their priorities. The underlying interests of the parties may be better revealed than through written submission processes, producing a better quality outcome. The adopted rules are likely to be workable and avoid pitfalls. A greater degree of communication between stakeholders enhances their understanding of the perspectives of other stakeholders and enabling them to refine and develop their own views. The government agency

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[32] Lubbers, above n 27, p 990.

[33] Pritzker D and Dalton D, *Negotiated Rulemaking Sourcebook* (1990) p 8.

[34] Coglianese, above n 27, p 2.

gets more clarity about stakeholder positions and rule impacts than the notice-and-comment process alone will commonly achieve, even if consensus is not reached in the negotiations.[35] The resulting rules may enjoy greater 'legitimacy', reducing subsequent judicial challenge.[36]

The main criticisms concern the time and resources involved in the negotiation stage:

> … by most accounts negotiated rulemaking demands much more concentrated amounts of time on the part of agency and non-agency participants.[37]

Reg-neg has only been used in a small proportion of US rulemakings. The Environmental Protection Authority (EPA) has perhaps carried out the largest number of negotiated rulemakings, but even so, these represented less than 10% of its major rulemakings.[38] This does not necessarily reflect a shortcoming in reg-neg because, as mentioned, it is suited only to certain situations. But the use of negotiated rulemaking has diminished in recent times. Data published by Coglianese and Lubbers indicates that the average number of federal reg-neg processes during 1999 to 2007 was 60% of the average number in the period 1985 to 1998.[39]

> The arguments for and against negotiated rulemaking are both important and interesting, but the compelling fact is that the actual use of the technique has fallen on very hard times. Even its most ardent supporters must admit that in recent years it has been used far less often than they would have predicted or preferred.[40]

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[35] Kerwin and Furlong, above n 27, p 207; Pritzker and Dalton, above n 33, p 8.

[36] Philip Harter, 'Assessing the Assessors: The Actual Performance of Negotiated Rulemaking' (2000) 9 *N.Y.U. Envtl. L.J.* p 32.

[37] Coglianese, above n 27, p 24.

[38] Coglianese, above n 27, p 21.

[39] Coglianese, above n 27; Lubbers, above n 27.

[40] Kerwin and Furlong, above n 27, p 209.

Some authors have noted an increased use of other, less formal, stakeholder engagement and negotiation processes.[41] For example, public meetings and workshops (but there are concerns about unclear objectives and the use of agency personnel as facilitators in these processes). It may also reflect a reduced commitment by agencies to consensus-based approaches, preferring a different balance between stakeholder engagement and agency control.

Its use may also be constrained by the resources of interest groups. Reg-neg relies on voluntary participation of all significant interests and its use is constrained by the requirement to have balanced committee representation.

Some suggest that the need to reach a consensus imposes a high degree of difficulty on participants, and discussion-oriented sessions not striving for consensus are sufficient.[42] Others argue that without the objective of consensus, parties will have incentives to take extreme positions and will not engage in good faith negotiations. This would produce little overall benefit.

It is also possible that the timing of reg-neg within the rulemaking process may conflict with, or not fully suit, the application of other statutory rulemaking requirements such as obligations to prepare cost-benefit analysis and evaluate alternative options on the basis of such analysis.[43] Ideally, such analysis would be carried out prior to or during the negotiation process. But it may be subject to improvement during the notice-and-comment process, and significant revisions to the analysis may put into question an earlier consensus. In some cases, negotiations may be appropriate at a later stage in the process, after the notice-and-comment process has commenced, but reg-neg proper does not provide for this.[44]

5 Options for Australian utility regulation

The comparison of negotiated settlement and reg-neg processes highlights

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[41] Coglianese, above n 27, p 59; Lubbers, above n 27, p 1003.

[42] Coglianese, above n 27, pp 60-61.

[43] Lubbers, above n 27, p 1000.

[44] Lubbers, above n 27, p 991.

several procedure issues relevant to stakeholder negotiation in Australian electricity network price regulation processes.

5.1 Inclusiveness

Presumably separate negotiations would be held between consumer representatives and each utility. In the negotiated settlement approach, a consensus reached would preclude any subsequent regulatory price review process. This could result in a narrowing of consultation and a loss of transparency, and possibly procedural fairness, compared to the consultative process currently used in Australian electricity network regulation.

The reg-neg process avoids this problem because after the negotiations have been conducted, whether they are successful or unsuccessful, the regulator proceeds with its normal process. The negotiations only affect the starting point of that process, and an agreement would be influential in that process, but it does not preclude the notice-and-comment process. Notice-and-comment processes are more accessible to the public than adjudication processes, so reversion to this process provides for wider comment from the public before a final decision is reached. This is an attractive feature of the reg-neg model.

5.2 Agency role in the negotiation process

In any stakeholder negotiation process there would need to be guidance from the regulator to ensure the outcomes are likely to be consistent with the overarching requirements. In some examples of negotiated settlement there is also *ad hoc* technical support, non-binding opinions and/or active facilitation. Critics suggests the guidance needed would be so extensive, there may be little purpose to the negotiation process:

> … regulatory settlements only work if the regulators have previously written down in immense detail exactly how they would carry out a formal regulatory review, so that everyone can predict the likely outcome. Regulated companies and their stakeholders cannot negotiate in a vacuum and anything they do agree has to be consistent with the legal obligations of the regulator. Companies can only negotiate with stakeholders once they know what the regulator would decide. Such settlements are therefore only an alternative

route to resolving disputes – not an alternative method of regulation.[45]

But this criticism may ignore the body of material from previous regulatory decisions that would assist to inform the negotiating committee and the scope for ad hoc advice.

The government agency does not have a guidance or facilitation role in the reg-neg process. It does actively participate in the negotiations, but only as one stakeholder among several. For reasons given by Darryl Biggar, and noted by the PC, the participation of the regulator in these negotiations may challenge its objectivity in its decision-making role later in the price determination process.[46]

In terms of the role of the regulator, the negotiated settlement process seems to have advantages over reg-neg. Rather than being a direct participant in negotiations, the regulator is an observer, and provides technical support and formal non-binding opinions on regulatory questions if needed.

5.3 Dispute resolution during negotiations

Some of the 'negotiated settlement' processes have suffered from lack of access to independent alternative dispute resolution (eg mediation, non-binding expert determination) at stages during the process. This was a concern raised by the Commerce Commission about the negotiation processes used in UK airport regulation. Availability of dispute resolution of this kind is usually seen as conducive to agreement, rather than reducing incentives to reach agreement.[47] In the reg-neg model, the negotiating committee is assisted by one or more skilled facilitator/mediators, including the neutral chair. The committee should also have the ability to obtain expert opinions where necessary.

5.4 Information gathering

The process needs to have sufficient clarity concerning:

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[45] Graham Shuttleworth, 'RPI-X@20: A Plan for Regulatory Regime Change' (2008) 178 *Power UK* p 39.

[46] PC, *Electricity Network Regulatory Frameworks, Draft Report, Volumes 1 & 2* (2012), p. 703; Darryl Biggar, 'Public Utility Regulation in Australia: Where Have We Got To? Where Should We Be Going?' (2011).

[47] Littlechild, above n 19, p 21.

- the process or powers for information gathering or discovery that would support the negotiation process
- the responsibility and timing of necessary analysis or information, (eg, cost-benefit analysis).

Negotiation processes are assumed to be of benefit because stakeholders can find solutions that best address their interests and priorities. However, if the negotiations take place with less information available to the parties than would be available to the regulator when making its decision, then it cannot be assumed to be a better outcome. The supporting role of the regulator would presumably include the provision of needed information and analysis. During negotiations, further analysis of alternative options may be needed. The adequacy of the information and analysis may depend on the timeframe permitted for negotiation and the preparation stages before it commences. A question may arise as to whether the negotiating committee should reconvene at some later point of the process if crucial information or analysis changes.

5.5 Post-negotiation decision-making process

In negotiated settlement, the regulator stands ready to determine the outcome if agreement can't be reached, moving into a formal adjudication or dispute resolution process. Reg-neg reverts to the notice-and-comment approach whether or not there is a negotiated consensus. The deliberations of the reg-neg committee can be used in subsequent stages, but in negotiated settlement the details of positions taken in negotiations are not available in subsequent stages. If stakeholder negotiation is adopted for electricity network regulation in Australia, care will be needed to ensure that the nature of the post-negotiation process is clear.

Reversion to a notice-and-comment process has the advantage of inclusiveness, as mentioned, and the ability to use the points of agreement and disagreement of the negotiating committee as the starting point for further consideration is also an advantage of the reg-neg approach.

This is not to suggest that the format of the informal hearings or public forums currently conducted could not be modified to better support the notice-and-comment approach. For example, Baldwin and Cave have suggested that, while notice-and-comment processes enhance transparency and fairness and should be retained for major regulatory rules, they suggest these processes may be improved with an 'increased role for inquiry-types of processes'.[48]

6 Conclusion

If consumer representatives are to play a direct negotiating role in energy network price determination processes, the available international examples support the view that they would need the support and leadership of a statutory consumer representative, distinct from the regulator.

There are different process models within which stakeholder negotiation can take place. Several of the examples of negotiated settlements take place within a quite different administrative process to that used in Australian energy network regulation, which is generally a notice-and-comment process supplemented by public forums. An alternative that has been considered here is the US negotiated rulemaking model ('reg-neg'), which would retain the mandatory notice-and-comment process. Although it may not save time and cost through the truncation of price review process, it appears to have some benefits with regard to transparency and inclusiveness.

More generally, comparing reg-neg with negotiated settlement has highlighted several procedural design issues that would need to be considered in order to implement stakeholder negotiation. A preferred model might draw elements from both of the broad kinds of processes considered here.

[48] Baldwin R and Cave M, *Understanding Regulation* (Oxford, New York, 1999) p 319.

7 References

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