

Trends in regulatory governance

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Background & Scope

- Context: Current review of NZ's regulatory arrangements for electricity naturally raises issues for gas regulation and the co-regulatory model
- Making gas markets work depends on getting regulation 'right'
 - Method of regulation
 - Institutions and governance arrangements
 - Consequences of failure can be significant
- What is regulatory best practice?
 - Can we apply recent experiences in Australia and UK?
 - Tentative conclusions for NZ gas market regulation



An outsider's perspective on NZ regulation

- Regulatory design appears to have been driven by:
 - A long-standing desire to find less costly and more innovative methods of regulation
 - Desire to avoid heavy-handed forms of regulation (e.g. Australia)
 - Extensive consultation with strong legal content
 - Transparent statements on Government energy policy
 - Evolving regulatory institutions and the law



What is “best practice” regulation?

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While there is no single "best approach" to the design of regulatory mechanisms and regulatory structures, experience suggests that successful regulation is underpinned by some common principles. These relate primarily to regulatory processes and practices. One example of these principles is those proposed by the OECD:

- ☐ Transparency;
- ☐ Accountability;
- ☐ Targeted;
- ☐ Consistent; and
- ☐ Proportionate.

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Source: ACIL Consulting, *A review of the New Zealand Gas Sector, A report for the Ministry of Economic Development*, October 2001, page 107.



Regulatory design & reform

- “Best practice principles” provide little guidance on:
 - the regulatory methods;
 - institutions; or
 - governance arrangements
- Typically, regulatory reform (methods; institutions and governance) follows a realisation that the current arrangements are sub-optimal
 - There is no off-the-rack ‘best practice’ model that can be rolled out
- Regulation is imperfect
 - Impossible to design costless administrative arrangements that eliminate the possibilities of distortions

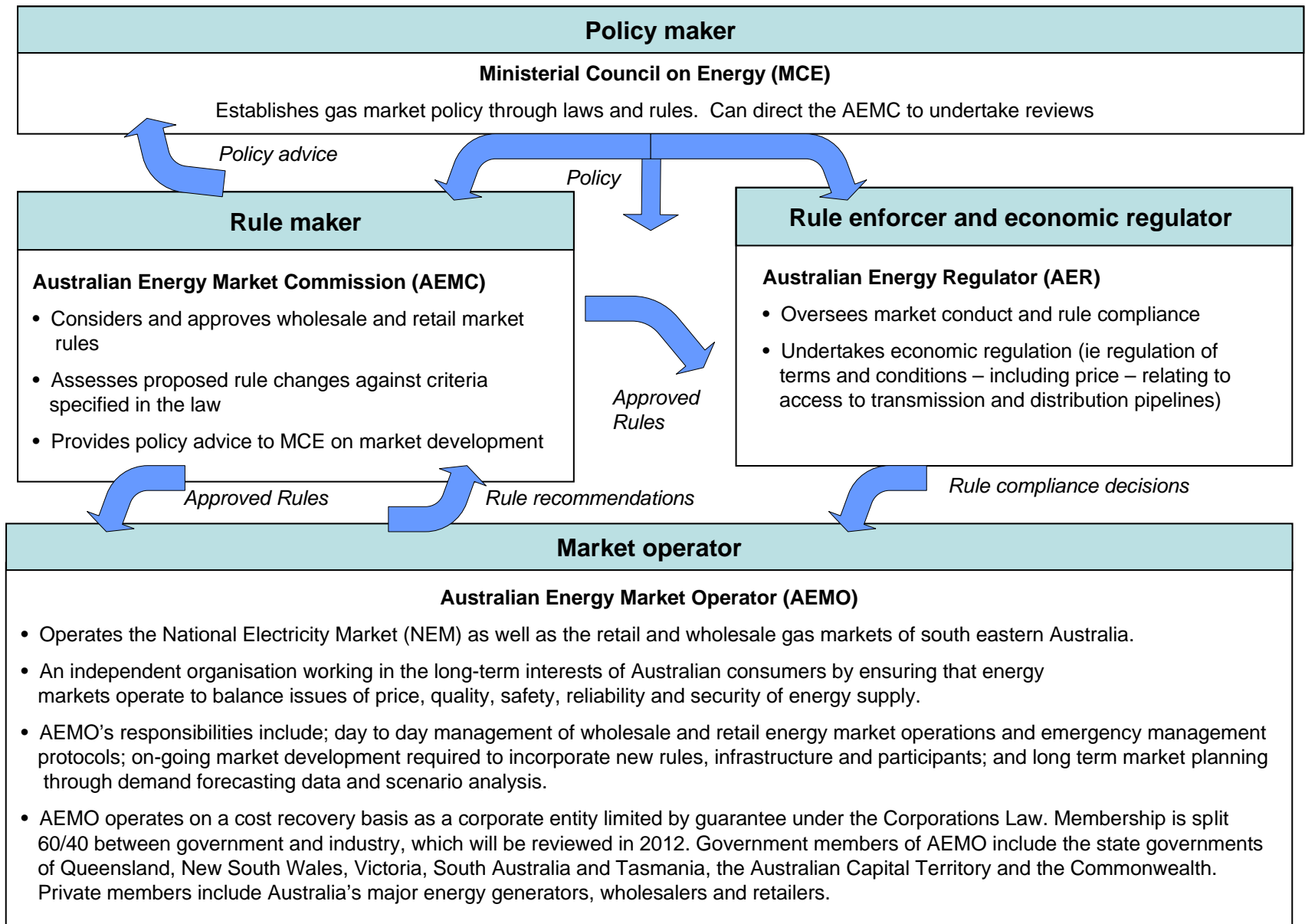


Recent reforms in Australia

- Early reforms did not deliver a truly national energy market
 - State-based regulators and derogations away from the national arrangements
 - Duplication of effort between NECA and the ACCC re authorising Code changes
 - Insufficient clarity regarding energy policy
 - Concern that ACCC's regulation of transmission lacked consistency
- Series of extensive reviews and reports from 2000 onwards
- Development of gas and electricity regimes should be brought closer together – regulatory methods; institutions and the governance arrangements; transmission planning; market operations and development
- Delineation between policy; rule-making; and rule-enforcement



Regulatory reform in Australia: Agency roles



Regulatory reform in the UK: Code Governance Review (1)

- Office of Gas and Electricity Markets (Ofgem) has several initiatives underway to deliver better regulation – including Code Governance Review
- Many of the technical and commercial rules and obligations that govern participation in Great Britain's gas and electricity sector are set out in a series of multilateral codes (required by licences)
- Process for delivering Code changes found wanting
- Particular concerns expressed by renewable generators experiencing difficulties obtaining access to transmission network. Review of transmission access initially blocked by industry.
 - “Code change process has not always been capable of dealing with major strategic issues and Government influenced policy challenges particularly where there have been strong divergences in views across industry.”



Regulatory reform in the UK: Code Governance Review (2)

Ofgem proposes to allocate its resources to “policy matters”

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"[.] we also consider that there is merit in ensuring that Ofgem's resources are focussed on codes issues that impact on competition and consumers. At present, Ofgem deals with a large number of modification proposals that have minimal impact on consumers and competition. There is also potentially unnecessary duplication of work by both the industry and Ofgem in assessing proposals of this nature.

Whilst many of these are housekeeping modification proposals, there are also a significant number of other proposals that introduce systems and process changes as well as minor governance changes that could be managed by industry without the need for Ofgem involvement. Indeed, ... we consider that approximately 50% of the modifications decided upon last year by Ofgem could have been managed by industry participants without Ofgem involvement."

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Source: Ofgem, *Code Governance Review: Major Policy Reviews and Self Governance*, 19th December 2008, page 9.



Regulatory reform in the UK: Code Governance Review (3)

- Ofgem’s initial proposals include a filtering process to determine the level of Ofgem involvement in Code change process
- Ofgem to define major policy issues and conduct “Major Policy Reviews”:
 - where Ofgem identifies a significant policy issue that appears to have implications for an industry code;
 - in response to Government-led public policy initiatives;
 - if an industry participant raises a code modification proposal within a key strategic area – impact on competition; cross code issues; or environmental; sustainable development or security of supply
- Criticism by industry that Ofgem is acting as “judge, jury and executioner.”
- Ofgem also recognised that there should be a greater role for self-governance



Conclusions from Australian and UK case studies

- Reform is driven by a dissatisfaction with existing performance:
 - Australia's fragmented gas and electricity markets and need for clearer delineation between policy setting; rule-making and rule-enforcement
 - UK's concern that the Code change process was not capable of delivering strategic reform
- In contrast to Australia, UK does not have clear separation of rule-making and rule-enforcement (recall “judge, jury, executioner”)
- Both case studies indicate:
 - A strong recognition of Government policy – ‘independent’ regulation does not operate in a vacuum
 - A role for ‘self-governance’ where industry expertise is needed to resolve issues that do not raise broader policy implications or impact competition or consumers
 - Different skill-sets required for economic regulation (revenue, pricing, investment & competition reviews) and market operations and development (industry expertise on technical operations including systems and processes)



Implications for the regulation of the New Zealand gas industry(1)

- Co-regulatory model is not out-of-step with approach in Australia or the UK
 - Co-regulatory model recognises that self-regulation has limitations, but industry should have ‘a seat at the table’ in relation to technical, operational market development issues
- In NZ, the Minister is not independent of the rule-making process
 - But, in practice, Government must have a role in utility regulation and the NZ arrangements in relation to Government policy are transparent
- New Zealand has different institutions and governance arrangements:
 - No sector-specific economic regulator;
 - No equivalent of the Australian Energy Market Operator;
 - Different laws and appeal processes;
 - Less distinct separation of policy-making; rule-making and rule-enforcement
 - But this reflects size of sector and its historical development



Implications for the regulation of the New Zealand gas industry(2)

- If required, could the co-regulatory model deliver major strategic reform?
 - Evidence from Ofgem's Code Governance Review suggests that it might not, especially if there are divergent views across the industry
- Is there a case for an Ofgem-style Major Policy Review, initiated by the Minister?
 - Maybe, if the performance and conduct of the gas industry warrants intervention
 - If an Ofgem-style Major Policy Review were required who would conduct it:
 - GIC; Commerce Commission; MED; or some special task force?
 - Do these organisations currently have the necessary powers or expertise to conduct a Major Policy Review?



Concluding comments

- Regulatory principles do not tell us much about optimal regulatory design – methods of regulation; institutions or governance arrangements
- Regulatory reform is typically driven by a dissatisfaction regarding current performance, rather than adopting an off-the-rack regulatory design
- In Australia and the UK have different regulatory governance arrangements, but both recognise the need to deliver on Government policy and provide a role for self-governance
- Based on experience in Australia and the UK, the success of the current NZ regulatory arrangements in gas will depend on:
 - Delivering on Government policy and price/service outcomes for customers
 - Whether the current model can deliver strategic reform when required

